

THE ATTORNEY GENERAL'S COMMITTEE  
ON ADMINISTRATIVE PROCEDURE

DEPARTMENT OF JUSTICE  
WASHINGTON, D. C.

SECURITIES AND EXCHANGE  
COMMISSION

MONOGRAPH NO. 26







# ATTORNEY GENERAL'S COMMITTEE ON ADMINISTRATIVE PROCEDURE

## DEPARTMENT OF JUSTICE

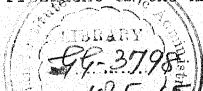
Washington, D. C.

This monograph is one of a series of studies submitted to this Committee by the investigating staff working under the Director. The members of the staff are Walter Gellhorn, Director, and Ralph S. Boyd, Kenneth C. Davis, Robert W. Ginnane, William W. Golub, Martin Norr, and Richard S. Salant.

These staff reports represent information and recommendations submitted to the Committee. They are not an expression of Committee findings or opinion. The Committee invites professional and lay criticism and discussion of the matter contained in these studies, both by written communications to it addressed to the Department of Justice, Washington, D. C., and by oral presentation at hearings which the Committee will hold in Washington on June 26, 27, and 28 and July 10, 11, and 12, 1940.

The Committee will make its report, setting forth its findings, conclusions, and recommendations after consideration of all the material submitted to it, including these reports of its staff, the record of oral examination of administrative officers, and the briefs, statements, and testimony which may be furnished by members of the bar and the public. These reports are made available in furtherance of this Committee's desire, first, that the information submitted to it by its investigators shall be public and, second, that all persons desiring to do so shall have full opportunity to criticize and supplement these reports.

The members of the Committee are Dean Acheson, Chairman, of the District of Columbia Bar, formerly Under Secretary of the Treasury; Francis Biddle, Solicitor General of the United States; Ralph F. Fuchs, Professor of Law, Washington University; Lloyd K. Garrison, Dean of the University of Wisconsin School of Law; D. Lawrence Groner, Chief Justice of the Court of Appeals for the District of Columbia; Henry M. Hart, Jr., Professor of Law, Harvard University; Carl McFarland, of the District of Columbia Bar, formerly Assistant Attorney General; James W. Morris, Associate Justice of the United States District Court for the District of Columbia; Harry Shulman, Sterling Professor of Law, Yale University; E. Blythe Stason, Dean of the University of Michigan School of Law; and Arthur T. Vanderbilt, of the New Jersey Bar, formerly President of the American Bar Association.





# SECURITIES AND EXCHANGE COMMISSION

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SECURITIES AND EXCHANGE COMMISSION\*

I

General

The Acts: history, purposes and provisions. The collapse of the stock market in 1929 and the consequent loss to investors and dislocation of the field of investment and finance in the following years turned the nation's attention at the beginning of the '30's to the reformation of investment and financial practices. First to receive legislative treatment was the securities market and in 1933 the Securities Act became law.<sup>1</sup> Shortly thereafter, the practices of "the Street" -- of stock exchanges, of trading, and of over-the-counter brokers and dealers -- were subjected to legislative regulation through the Securities Exchange Act.<sup>2</sup> In 1935, the Public Utility Holding Company Act<sup>3</sup> was passed "to provide for control and regulation of public-utility holding companies, and for other purposes." In 1938, chapter X of the Bankruptcy Act<sup>4</sup> provided for federal participation in corporate reorganizations, and finally, in 1939, the Trust Indenture

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1. 48 Stat. 74; 15 U.S.C., sec. 77 (a) et seq.
  2. 48 Stat. 881; 15 U.S.C., sec. 78 (a) et seq. The Maloney Act of 1939 added further legislation concerning brokers, dealers, and over-the-counter practices.
  3. 49 Stat. 838; 15 U.S.C., sec. 79 et. seq.
  4. 52 Stat. 883; 11 U.S.C., sec. 501 et seq. In general, the Chandler Act provides that where the total indebtedness does

\* This monograph was submitted May, 1940, and finally revised June, 1940.



Act supplemented the Securities Act of 1933 by regulation of the practice, operations, and security transactions of trustees under indenture. Because the detailed machinery for administration of the Trust Indenture Act has not yet been completely established, and since under the Chandler Act the Securities and Exchange Commission's functions are advisory only, discussion herein will focus upon the first three statutes.

(1) The Securities Act of 1933. The stated objective of the Securities Act, sometimes known as the "Truth-in-Securities Act", is "To provide full and fair disclosure of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes." No powers over management are provided; nor may the Commission exercise judgment concerning the soundness of the investment offered. Rather the sole concern of the Act is that, regardless of the merits of the issue, the truth concerning it must be publicly disclosed. In general, and

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4. (Cont'd.) not exceed \$3,000,000, a federal court may, and where the indebtedness exceeds \$3,000,000, it must, refer reorganization plans to the Securities and Exchange Commission for examination and report. The Commission may on its own motion, and must at the request of the court, intervene in reorganization proceedings.

5. 53 Stat. 1149; 15 U.S.C., sec. 77aaa et seq.

6. Hereafter referred to as the Securities Act, or the '33 Act.

7. Some qualification to these assertions must be added since, of course, judgment concerning "truth" necessarily involves

(Continued)

with the exception of exemptions of certain securities and transactions in securities, the Securities Act closes the mails and the channels of interstate commerce or communication to the sale, delivery, or purchase of securities in respect of which no registration statement is in effect (Section 5). Section 6 provides for the registration of such securities, while Section 7, and Schedules A (in the case of domestic securities) and B (for foreign securities) prescribe the information and documents required in registration statements. Section 10 imposes parallel requirements in respect of prospectuses relating to securities. Section 8, the administrative provision, deals with the circumstances and conditions under which registration statements and amendments thereto take effect or may be suspended.

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9

(2) The Securities Exchange Act of 1934.

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7. (Cont'd) judgment concerning the management policies and soundness of securities. Thus the Commission may determine that the prospects of a particular security are bad. Although it cannot prevent the offer of such securities, it can and does require disclosure of the facts of management, or of the enterprise, which will apprise investors of the unsoundness of the security. Except for the limited purpose of ascertaining what should be disclosed, no judgment as to management or soundness is exercised.

8. In general, it may be noted that the Securities Act vests considerably less discretion in the Securities and Exchange Commission than do the other Acts. A former chairman of the Commission has attributed this to the fact that at the time of the Securities Act's passage, public and legislative confidence in the Federal Trade Commission, which was vested with the duty of administration, was at a low point. Landis, The Administrative Process (1938) 54.

9. Hereafter referred to as the Exchange Act, or the '34 Act.

Designed "To provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes," the Exchange Act is broader than the Securities Act both in the variety of subjects covered and in the discretion vested in the administrative. In

general, the '34 Act treats of six different but related subjects: (1) Registration of and supervision over securities exchanges; (2) margin requirements and restrictions on borrowing; (3) manipulation of security prices; (4) segregation and limitation of functions of exchange members, brokers, and dealers; (5) registration of securities for trading on exchanges; and (6) registration of over-the-counter brokers and dealers and supervision of their general trade practices.

Section 5 forbids any broker, dealer or exchange to use the mails or any means or any instrumentality of interstate commerce for

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10. "Great differences ... will be found to exist between the discretionary activity given to the administrative under the Securities Act of 1933 and the Securities Exchange Act of 1934. Broad powers to exempt securities from the operation of the 1934 Act were granted to the Commission ... The data required of registering corporations under the 1934 Act were only briefly indicated and even the disclosure of these was not mandatory. On the other hand, under the 1933 Act the requirements were extensive and the power ... to detract from the statutory demands was severely limited." Landis, op. cit. supra, note 8, pp. 52-54. Landis attributes these differences to a return of legislative confidence in the ability of the Federal Trade Commission and a new appreciation of the technical difficulties of securities regulations and their requirement of flexible methods of handling. Id., pp. 54-55. It is to be noted, however, that officials of the Registration Division minimize the differences in discretion permissible under the two Acts: they feel that their powers to require information in respect of security registrations under the '33 Act are virtually as broad as those under the '34 Act.

commerce for the purpose of using any facility of an unregistered exchange, unless such exchange has been exempted. Section 6 prescribes the methods for registration of exchanges and the conditions under which such registration may be effected. Section 7 empowers the Federal Reserve Board to set margin requirements and Section 8 restricts borrowing by members, brokers, and dealers. Sections 9 and 10 govern manipulation of securities prices, and the use of manipulative and deceptive devices. Section 11 deals generally with the segregation and limitation of functions of members of exchanges, brokers, and dealers.

Section 12 prohibits any member, broker, or dealer from effecting any transaction in any security (other than an exempted security) on a national (i.e., registered) securities exchange unless a registration for such security for such exchange is in effect; it further governs the methods for the registration of securities, the conditions under which registration will take place, the withdrawal of securities from listing and registration, and the extension of unlisted trading privileges and the termination thereof. Section 14 forbids the solicitation of proxies in respect of securities in contravention of rules and regulations prescribed by the Commission.

Section 15 deals with over-the-counter markets; this Section makes it unlawful for any broker or dealer to use the mails or any means or instrumentality of interstate commerce

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to effect any transaction in, or the purchase and sale of, any security (with certain exceptions) otherwise than on a national securities exchange unless such broker or dealer is registered in accordance with the requirements of the Act. Section 15 A, the Maloney Act, provides for the registration of any association of brokers or dealers as a national securities association. A novel experiment in official government-business cooperation, its aim is to achieve through such associations "fair trade practices" of brokers and dealers by requiring rules and regulations of such association to govern such practices, and by vesting the Commission with residual powers over the activities of the association.

Section 16 governs the transactions of directors, officers and stockholders in securities of their own companies: It requires publicity for such transactions and makes such persons ineligible (with certain exceptions) to retain the profits of any purchase and sale within a period of six months or less.

11

(3) The Public Utility Holding Company Act of 1935.

In contrast to the Securities Act and the Exchange Act, the Holding Company Act provides for closer supervision and control of the industry with which it deals. The Holding Company Act, in general, imposes upon holding companies, their subsidiaries and affiliates, requirements of federal approval of

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11. Hereinafter referred to as the Holding Company Act.

the major financial transactions of the management. After defining "holding company", "subsidiary", "affiliate", "electric utility company," "gas utility company," and other terms, and providing for administrative declarations in regard to such terms (Section 2), and after further providing for self-executing as well as administrative exemptions (Section 3), the Holding Company Act makes it unlawful for an unregistered holding company (1) to sell, transport, transmit or distribute, or own or operate any utility assets for the transportation, transmission, or distribution of, gas or electric energy in interstate commerce; (2) by the use of the mails or any means of interstate commerce, to negotiate or perform any service, sales or construction contract for any public-utility or holding company; (3) to use the mails or means of interstate commerce to distribute or make any public offering for sale or exchange of any security of any such holding company and subsidiary or affiliate of such holding company, any public-utility company, or any holding company; (4) by the use of the mails or any means of interstate commerce to acquire or negotiate for the acquisition of any security, or utility assets of any subsidiary or affiliate of such holding company, any public-utility company, or any holding company; (5) to engage in any business in interstate commerce; or (6) to own, control, or hold with power to vote, any security of any subsidiary company that does any of the acts enumerated in (1) to (5) (Section 4). Section 5 provides for registration



of a holding company and prescribes the information to be supplied. Unlike registrations under the Securities Act and the Exchange Act, there is no provision for the denial or revocation of a utilities registration.

Section 6 prohibits a registered holding company or subsidiary thereof from issuing or selling any security of such company or from exercising any privilege or right to alter the priorities, preferences, voting power or other rights of an outstanding security of such company unless (with certain exceptions) in accordance with an effective declaration. Section 7 prescribes the methods for filing declarations in respect of this type of security transaction, and the conditions under which the Commission will permit them to be effective. Sections 9 and 10 contain parallel provisions in regard to acquisition of securities, utility assets and other interests in any business by a registered holding company or subsidiary. In general, such acquisitions are unlawful unless the Commission has first approved an application therefor.

Section 11 deals with corporate simplification and geographical integration of holding company systems. Section 11 (b) (1) empowers the Commission to order each registered holding company and subsidiary to take such action as is found necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system and to such other businesses as are reasonably

incidental, or economically necessary or appropriate to the  
operations of such integrated public-utility system.<sup>12</sup> Section  
11 (b) (2) empowers the Commission to order action to  
ensure that the corporate structure or continued existence of  
any company in the holding-company system does not unduly com-  
plicate the structure, or unfairly or inequitably distribute  
voting power among security holders, of such holding-company  
system. Section 11 (e) permits any registered holding com-  
pany or subsidiary voluntarily to submit plans looking toward  
simplification and integration for approval by the Commission.  
Section 11 (f) provides that no holding company or subsidiary  
reorganization plan shall be submitted to a court without prior  
approval of such plan by the Commission. In addition, this  
Section and Section 11 (g) vest the Commission with powers in  
regard to fees, expenses and remunerations in connection with  
reorganization, dissolution, liquidation, bankruptcy or re-  
ceivership proceedings, and in regard to solicitation of  
proxies in respect of reorganization plans.

Section 12 prohibits registered holding companies  
or subsidiaries from entering into a variety of financial trans-  
actions in the absence of prior sanction by the Commission.  
Such transactions include: (1) Loans, extensions of credit

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12. To this subsection is attached a proviso whereby under  
certain conditions a registered holding company may be per-  
mitted to continue to control one or more additional inte-  
grated public-utility systems.

to, or indemnifications of, any company in the same system;

(2) declaration or payment of dividends on any security of such company, or acquisition, retirement or redemption of any security of such company; (3) sale by such company of any securities which it owns of any public-utility company, or any utility assets;<sup>13</sup> (4) solicitation of proxies regarding any

security of such companies; and (5) negotiation or performance by such companies of any other transaction with any company in the same system or with any affiliate thereof.<sup>14</sup> Section

12 (h) unconditionally prohibits political contributions by holding companies or subsidiaries, while section 12 (i) requires disclosure of details of employment in regard to legislative, legal or other representatives of holding companies and subsidiaries.

Section 13 deals with the performance of service, sales, and construction contracts; subsection (a) altogether prohibits, except in unusual circumstances, performance of such contracts by a registered holding company for any utility or mutual service associate. Section 13 (b) requires

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13. Prior to approval of this type of transaction, the Commission shall consider competitive conditions, fees and commissions, consideration to be received, accounts, disclosure of interest, and similar matters.

14. Section 12 (g) applies to similar transactions by affiliates. Reports, accounts, costs, maintenance of competitive conditions, disclosure of interest, duration of contracts, and similar matters are to be taken into consideration prior to approval.

Commission approval prior to the performance of such contracts by  
15  
subsidiaries. Section 13(d) provides for the approval of mutual  
service companies and permits the Commission to regulate their  
organization, their allocation of costs and similar matters.  
Section 15 gives the Commission supervision over the methods of  
keeping records and accounts; Section 17 requires disclosure of  
the ownership of securities in their companies by officers, director  
and other affiliates, and provides for the disgorgement of profits  
gained through certain transactions in such securities by such  
persons.

Sanctions. The three Acts just described provide, with  
varying degrees of complexity, a complete network of sanctions to  
achieve compliance. Under each, the sanctions fall into three  
main groups: (1) administrative; (2) criminal; and (3) civil,  
including injunctions, mandamus, and civil liabilities. In  
addition, the first group - the administrative - includes not  
only the sanction of prohibition, but also the sanction of pub-  
licity and of indirect though official disbarment from business.

Basically, the structure of sanctions is similar for  
each Act: They are the sanctions ordinarily attached to the  
powers of licensing. The administrative sanction is the first  
line of defense - the prophylactic (although, as noted below,

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15. Sections 13(e) and (f) contain parallel provisions in  
regard to performance of such transactions by affiliates and  
other persons whose principal business is the performance of  
such contracts.

it may, in some instances be utilized simultaneously with or subsequent to the judicial sanctions): Thus, under the Holding Company Act, which presents the simplest sanction structure, the administrative sanction is simply one of withholding approval of various acts and transactions not conforming with the statute. The consequence of such withholding is to make illegal the use of the mails or the means or instrumentalities of interstate commerce for such acts or transactions. Similarly, under the Securities Act the Commission's refusal to permit a registration of securities to become effective, or its suspension of effectiveness, makes unlawful the use of the mails or the channels of interstate commerce by any person as to transactions in such securities. In the case of the Exchange Act, the facilities of a national securities exchange are closed to trading in securities for which the Commission has refused or revoked the registration for trading thereon, while the use by a broker or dealer of the mails or the channels of interstate commerce for over-the-counter trading is made illegal if the Commission has denied or revoked the registration of such broker or dealer.

If the Commission refuses to permit these various registrations to become effective or revokes such registrations, it is unlawful, as already described, to use the mails and the channels of interstate commerce, or the facilities of an exchange, as the case may be; and the Commission may seek an injunction to prevent such use, or a writ of mandamus to

enforce compliance with the several Acts. In addition to injunction proceedings, each of the three Acts provide for references of cases by the Commission to the Department of Justice for the institution of criminal proceedings. Wilful violation of the Securities Act subjects the violator to a fine of not more than \$5,000 or imprisonment for not more than five years, or both.<sup>17</sup> Wilful violation of the Exchange Act entails a fine of not more than \$10,000 or imprisonment for not more than two years, or both, except if the violator is an exchange, the fine may be \$500,000. Failure to file information documents, or reports which keep current the information in '33 Act registrations pursuant to an undertaking contained in such registration statements, as provided in Section 15(d) of the '34 Act, entails a penalty, recoverable in a civil suit in the name of the United States of \$100 for each day's continuance of such failure to file.

In addition to the remedies available to the Commission or

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16. The remedy of mandamus has not been utilized. During the fiscal year ended June 30, 1939, 69 suits were instituted by the Commission to enjoin violations of the three Acts, while the total number of such cases instituted prior to July 1, 1939, was 288. With a single exception, the Commission was successful in every injunctive action prosecuted and disposed of during the last fiscal year.

17. Up to July 1, 1939, 1096 persons had been indicted in 158 cases. In the 98 cases disposed of, 403 defendants were convicted.

For general discussions of the criminal sanctions under the Securities Act, see MacIntyre, Criminal Provisions of the Securities Act and Analogies to Similar Criminal Statutes (1933) 43 Yale L. J. 254; Herlands, Criminal Law Aspects of the Securities Act of 1933 (1933) 67 U. S. Law Rev. 562, 615.

to the United States, each Act opens to private persons remedies of financial recovery through subjecting violators to extensive civil liabilities. Section 11 of the Securities Act exposes registrants and those participating in the preparation of a registration statement to civil liabilities on account of false statements therein; Section 12 similarly imposes civil liabilities in respect of prospectuses and communications. 18

The Exchange Act imposes parallel liabilities: (1) upon persons violating the prohibitions against the use of manipulative devices; and (2) upon persons who make false statements in any report, application or document filed pursuant to that Act. Finally, under the Holding Company Act, civil liability is imposed upon persons making, or causing to be made, any false statements in any application, report, registration statement, or document

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18. The breadth of the civil liabilities of the '33 Act, sharply departing as it did from the principles of caveat emptor, and shifting the burden upon the vendor, was a focal point of controversy at the time of its passage. Cf. Douglas and Bates, The Federal Securities of 1933 (1933) 43 Yale L. J. 171, 174-182; Shulman, Civil Liabilities and the Securities Act (1933) 43 Yale L. J. 227. But the fears that unwitting violations might subject innocents to civil suits appear to have been unfounded. So far as is ascertainable, such suits are rare. It has been pointed out that the purpose of the administrative sanctions of stop and refusal orders is protective, and serve as "the first line of defense against bad security issues. It can and should become the main line of defense"; although permitting a registration statement to become effective is not an official guarantee or assurance of the truth therein, ordinarily false statements which would subject registrants to civil liability will be detected before harm can be done. Cf. Rodell, Regulation of Securities by the Federal Trade Commission (1933) 43 Yale L. J. 272, 274.

filed thereunder.

Various complications, however, have been imposed upon the simplicity of the pattern of sanctions described above, since the Exchange Act departs from the simple licensing process and adds a number of novel penalties. As already noted, a broker or dealer can be disbarred from over-the-counter business through denying him the use of the mails or the means and instrumentalities of interstate commerce if his registration is refused or revoked. Such disbarment is a sanction not only to obtain compliance with the requirements of the '34 Act, but it also serves to compel observance of the '33 Act, since a broker-dealer registration may be denied or revoked for wilful violation of the provisions of the latter Act. A similar administrative disbarment is permissible under Section 19(a) (3) of the Exchange Act: Violation of any provision of that Act subjects any officer or member of a national securities exchange to expulsion or suspension therefrom by the Commission.<sup>19</sup> Further, powerful official but indirect sanctions are added

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19. "In many respects these proceedings are of the greatest significance. They represent the use of a novel and unusual sanction for the enforcement of a federal statute. They are in the nature of criminal proceedings, as the penalty of expulsion or suspension may have far greater consequences than any fine which may be imposed under the Act. Expulsion from national securities exchanges and the refusal of registration of a broker or dealer in the over-the-counter market . . . would effectively bar the respondent from the right to engage in a securities business. The very means of livelihood may therefore be taken away from the person subject to this form of penalty." Redmond, The Securities Exchange Act of 1934: An Experiment in Administrative Law (1938) 47 Yale L.J. 622, 636-637.



by Section 19 (a) (1) of the '34 Act, and Section 15 A (the Maloney Act), to assure ethical conduct on the part of dealers and brokers. Under Section 19 (a) (1), an effective stimulus is supplied the Commission to obtain self-policing by a national securities exchange: The Commission is empowered to suspend or withdraw the registration (without which it is illegal to do business) of a national securities exchange if the exchange has failed to enforce, so far as is within its power, compliance with the '34 Act by a member or by an issuer of a security registered thereon. With a provision of this nature at its disposal as a threat, it may well be imagined that at least when the exchange has power, a private group will often impose the sanction of suspension or expulsion without necessitating the Commission's taking action to do so under Section 19 (a) (3).<sup>20</sup>

A more elaborate framework for the imposition of sanctions by the administrative through a private association was provided by the Maloney Act, governing the registration of securities associations of brokers and dealers. While membership in such an association is technically voluntary, since Section 15 A (i) (1) permits non-members to be barred from obtaining brokers' discounts, membership is substantial aid to the

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20. Further supervisory pressure upon the exchange to persuade it to clean its own house is provided through the Commission's general powers over an exchange's rules and regulations under Section 19 (b). See Fifth Annual Report of the SEC (1940) 35-40.

successful continuance of over-the-counter business by a broker or dealer. Not only is a securities association expected to provide for fines and other disciplinary action for the violation of a fair trade code, but in order to be registered, an association must provide through its rules that membership will be denied to a broker or dealer (1) who has been expelled from a national securities exchange for violation of any rule of the exchange prohibiting any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or (2) who is subject to a Commission order denying or revoking his registration or expelling him from an exchange.

It will thus be seen that many of the sanctions are complementary as well as cumulative. For example, if a person wilfully makes untrue or misleading statements in a registration statement filed under the Securities Act, the following consequences are possible: (1) the Commission may refuse to register the security or may issue a stop or refusal order; (2) further dealing in such security may be enjoined; (3) the registrant may be criminally prosecuted; and (4) the registrant and others who participated with him are civilly liable. If the underwriter is responsible for the misstatements and is a registered broker or dealer (1) his registration is subject to revocation; and (2) he is required to be expelled from a national securities association. If the false statement in a registration is not wilful, a stop or refusal order, or an injunction, as well as civil liability, may result; if a stop or refusal order issues, any person using the mails or the channels of interstate commerce to sell the security is subject to

criminal prosecution or injunction, and, if such person is registered broker or dealer he is subject to the various expulsions and revocations just described.

Criteria for choice of sanctions. As will be noted from the preceding description, several sanctions may be available for the same act or series of acts: If a broker or dealer engages in manipulation in violation of Section 9 of the Exchange Act, for example, the Commission may either proceed administratively to expel or suspend him from a national exchange if he is a member thereof, or to revoke his registration, or could go into the appropriate federal court for an injunction, or could refer the matter to the Department of Justice for criminal proceedings. Similarly, a false registration statement under the '33 Act opens the way to administrative stop or refusal orders, injunction, or, if wilful, criminal proceedings, while an improper securities registration application under the '34 Act would make possible administrative delisting proceedings or criminal reference.

The factors which control the Commission's choice of sanctions, where several sanctions are available, are impossible of precise description; each case is said to depend on its own facts. However, in general, it appears that the injunction is regarded as the lightest sanction, the administrative (except in the case of

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21. In addition, denial or revocation is possible if the broker or dealer has been enjoined from, or convicted for, such violation of Section 9. Thus the Commission could seek an injunction or refer the matter to the Department of Justice for criminal proceedings; if successful, the registration could be revoked or denied.

stop or refusal orders under the Securities Act), the medium, and  
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criminal reference the severest. Where the prescribed activities

comprise a harmful course of conduct demanding quick remedy, the Commission will be likely to seek a preliminary injunction, which it is said, can ordinarily be obtained in a day. Further, other factors are said to enter into a current preference for resort to the courts over administrative proceedings; (1) The latter, entailing the utilization of trial examiners and other staff members, stenographic services and the like, and more expensive to the Commission than court proceedings; (2) a major part of the Commission's time must now be devoted to the problems under the Holding Company Act; and (3) the current outcry against the combination of judge, jury, and prosecutor has led the Commission to relieve itself of the first two functions wherever possible. 23 Of course, the choice of one of the available remedies does not preclude subsequent resort to others. Indeed, an injunction is often sought to restrain a harmful course of conduct pending decisive administrative action, and, in turn, as already noted, an injunction against a broker or dealer may furnish the ground for the revocation of such registration under Section 15(b) of the Exchange Act. Similarly, administrative action may be a prelude to reference to the Department of Justice for institution of criminal proceedings: Attorneys in the

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22. But compare the statement of Mr. Redmond, supra, note 19.

23. It is interesting to note that the courts have been sympathetic to the several Acts and that a very high percentage of successful proceedings therein have marked the Commission's litigation. See supra, footnote 16. In addition, it should be observed that the Commission's ready and successful recourse to the courts may be due to the fact that much of the subject-matter under the '33 and '34 Acts is of the type (such as mail fraud and the like) to which the courts have long been accustomed.

interpretative section of the General Counsel's office, who analyze the record of decisive administrative hearings, are under instruction to examine all such records with a view toward criminal reference and to prepare a memorandum thereon recommending whether there should be such reference.

Finally, it may be observed that in addition to this wide variety of sanctions, the statutes provide the Commission with the further power of bringing violations and abuses into the open through public investigations. This power has been invoked in three notable cases -- that involving the defalcations of Richard Whitney and the failure of his firm, the falsification of accounts in the matter of McKesson & Robbins, Inc., and recently, the alleged political contributions and falsification of accounts in violation of the Holding Company Act by Union Electric Company of Missouri. In these instances, involving fundamental issues of a public interest, the Commission has been in the position of a public prober, conducting investigations which lead to no final orders, but which do lead to public reports -- devices which are not only useful in revealing the need for further legislation or further exercise of the rule-making power, or revealing grounds for the institution of decisive administrative or court proceedings, but which the Commission believes should also be of extraordinarily healthy effect in stimulating compliance with the requirements of the Acts has been used in cases of less public interest: For example, a

public hearing was held in connection with the registration of a security for trading under the Exchange Act; a report in the form of a decision and discussion was publicly issued, but no decisive proceedings or delisting followed, because the public investigation and discussion were sufficient to bring about the specific correctives and no purpose would have been served by imposing the sanction of delisting, which always involves inconvenience to innocent security holders. It is important to note, too, that even where decisive proceedings are brought and violations are found, the Commission will not invariably impose a sanction. Thus, in a recent case involving the revocation of a broker-dealer registration, although the Commission expressly found that wilful violations had been committed which would serve as ground for revocation, the circumstances and the character of respondents were such that sentence, so to speak, should be suspended since the publicity and hearing were sufficient sanction without superimposing the severer penalty of disbarring the respondents from further business.

Judicial Review. Each of the three statutes provides for judicial review of the orders of the Commission. Section 9 (a) of the Securities Act, Section 25 (a) of the Holding Company Act, permits petitions to the appropriate Circuit Courts of Appeals within sixty days after the entry of the Commission's order. The Securities Act provides that "any person aggrieved" by an order may seek review; the Exchange Act limits the right of review to "any person aggrieved" by an order issued by the Commission under that Act "in a proceeding to which such person is

a party"; the Holding Company Act permits "any person or party aggrieved" by an order to petition for review. Under the terms of the '33 Act; the Commission's findings of fact are conclusive on review if "supported by evidence"; the two later statutes, on the other hand, require the Commission's findings of fact to be "supported by substantial evidence". As these terms have been interpreted by the courts, the differences in wording is inconsequential.

In contrast to the orders of other agencies such as the National Labor Relations Board, the Commission's orders are, in a measure, self-executing and judicial approval is not necessary prior<sup>24</sup> to their full effectiveness. Since, as already noted, in most instances under the several Acts administered by the Commission the orders are in effect denials or revocations of licenses to engage in various types of activities or transactions, the Commission need take no further steps, after the issuance of its order, to enforce its order; the unlicensed actions thereafter are unlawful and subject to injunction or criminal penalties.

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24. In two instances, this self-executing characteristic may be absent: (1) in the case of its integration and simplification orders under Section 11 of the Holding Company Act, Section 11 (d) provides that the Commission may apply to a court to enforce compliance with such orders; (2) in the case of an order under Section 19 (a) (3) expelling or suspending a member from an exchange, there is no clear method of enforcement of such order, if the exchange (which is not a party to the proceeding and against whom no order is issued) refuses to expel or suspend. In fact, under this Section, the broker has simply refrained from business upon the issuance of an order; no steps were taken by the exchanges.

At least as to some of the orders issued by the Commission, the right of judicial review is one which has been described in an address by its General Counsel as "without practical content;" the "remedy of appeal is not adequate" and cannot be adequate simply because the exigencies of time do not permit of the necessarily slow relief which a court may afford. Appeals from denials of exemptions or from integration and simplification orders under the Holding Company Act; and appeals from orders of expulsion or suspension from an exchange or from denials or revocations of a broker-dealer registration under the Exchange Act do have, of course, considerable significance. But administrative action upon applications for permission to engage in various financial transactions - e.g., refusal to permit a registration statement in respect of the issue and sale of securities under the '33 Act to become effective; or disapproval of the issue and sale or acquisition of securities under the Holding Company Act - is "to all intents and purposes, final." <sup>25</sup> Practical factors underlie this phenomenon: Not only must securities be "like Calpurnia, above suspicion" in order that they may be sold, but in addition timing may often be of the essence for security transactions, and even though the Commission's order might ultimately be reversed by a reviewing court, "the time that elapses before such relief can be procured will have permanently chilled the market for the securities." <sup>26</sup>

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25. Landis, op. cit. supra, note 8, p. 109. Mr. Landis has pointed out the extreme infrequency of such appeals.

26. Id.



The Commission: organization and personnel. Administration of the Securities Act of 1933 was originally vested in the Federal Trade Commission; Section 4 (a) of the Exchange Act, however, established a Securities and Exchange Commission which was made responsible for the administration of the '33 and '34 Act, as well as, subsequently, the Holding Company Act, the Trust Indenture Act, and the performance of certain duties under the Chandler Act. Section 4 (a) of the Exchange Act provides that the Commission is to be composed of five commissioners to be appointed by the President with the advice and consent of the Senate and to be paid an annual salary of \$10,000. The chairman of the Commission is chosen by vote of the several commissioners. Each commissioner's term of office is five years, but the initial appointments are staggered over a five-year period. Commissioners are forbidden to engage in any other business,

27. "Despite the fact that I took a contrary position in 1934, today I am convinced that securities regulation has had a happier history through having had its administration intrusted to a separate commission rather than continuing the Federal Trade Commission as the administrative . . . By creating a new Commission . . . it was possible to have individuals in charge whose single concern was the problem of securities regulation. They were thus not required to dissipate their energies over a wide periphery by being responsible for problems of equal public importance but which bore no discernible relationship to securities regulations. The creation of a new Commission also permitted freedom in shaping its internal organization. Overhanging habits and traditions of operation that had been developed as a result of association with a different problem did not mold the new growth. Furthermore, it was not essential to approach the new problems in a way that required their synthesis with pre-existing policies, as would have been the case had such new regulating duties been intrusted to an established body." Landis, *ibid.* pp. 26-27. But quære, has there not been some departure from a policy against "dissipation" of energies over a wide periphery by the addition to the original two statutes of the Holding Company Act, the Chandler Act, and the Trust Indenture Act (although, indeed, some common denominator - furnished by the general attention to "financial" matters in all five acts - is readily discernible)?

vocation or employment, nor may they participate directly or indirectly in any stock-market operations or transactions of a character subject to regulation by the Commission. Section 4 (a) also provides that not more than three of the commissioners shall be members of the same political party, and in making appointments members of different political parties shall be appointed alternately as nearly as may be practicable. It would seem that requirements in the nature of a political affiliation should be irrelevant to the performance of the type of tasks before the Commission and that they appear needlessly, if not seriously, to limit the reservoir of available talent from which to choose; nevertheless, so far as is ascertainable from the Commission's formal decisions and public policies, no tendency to split along political lines is apparent.

At the close of the fiscal year ended June 30, 1939, there were 1,571 employees, 1,244 of whom were stationed in the central office in Washington, and 327 in nine regional offices (Fort Worth, New York, Atlanta, San Francisco, Seattle, Chicago, Denver, Cleveland, and Boston) and one field office (Washington). The Commission's officers, attorneys, examiners and other experts may be appointed without regard to civil-service requirements; <sup>28</sup> the remaining employees of whom there were 931 are subject to civil-service. The total sum appropriated for the Commission for the fiscal year ended June 30, 1939 was \$4,872,000.

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28. A phenomenon whose precise consequences or importance are difficult to gauge is the comparatively high turn-over among the subordinate attorneys who assist the Commission in its adjudicatory and regulatory work. Various reasons are assigned for this — among them a distaste for too long a period of concentrated desk-work, and infrequent (con-

In general, as is noted more specifically below in discussion of the procedures, the staff is divided on a functional basis and largely according to the types of duties under the several statutes which the Commission administers. There are, thus, four chief administrative divisions: (1) The Registration Division; (2) the Trading and Exchange Division; (3) the Public Utilities Division; and (4) the Reorganization Division. In addition, the Legal Division acts generally as legal adviser to the Commission and the public regarding statutory interpretations and other legal problems arising under the statutes, and represents the Commission in civil litigation in the courts.

Centralization. A chief characteristic of the organization of the Commission is the high degree of centralization which obtains. How this affects specific procedures in adjudication is described in Part II of this Monograph, but it may here be noted that in general the proportionately small field staff is engaged chiefly in investigations and court litigations; it is confined to what may be described as leg-work and vested with little discretion. Almost all activities of the field staff must be checked through the Washington offices.

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28 (Cont'd) or insufficient salary raises. The training of an expert corps of subordinate attorneys, especially when they are vested with some degree of responsibility in technical fields, is an important part of the proper functioning of the administrative.

The Commission follows no policy of shifting its attorneys from division to division, and, indeed, the necessity for speed and specialization would seem to make this impossible. On the other hand, often new attorneys acquire general training in the General Counsel's office and thereafter are shifted to special divisions.

Nor has the membership of the Commission been static. Since its creation, the Commission has had 12 different members, including four chairman.

Even preliminary negotiations, concerning, for example, reorganization plans under Chapter X (although in fact, under Chapter X, such conferences take place in the field and dispose of many of the questions so that only a residual supervisory power remains in Washington), or deficiencies in registration statements under the '33 Act, or proxies under the '34 Act, must be reported to and passed upon by the appropriate division in Washington.

The advantages and disadvantages of such centralization balance each other to a considerable degree. On the one hand, the lack of autonomy of the field staff gives rise to a certain amount of delay where quick negotiation and decision are necessary. For example, where proxies are submitted to the Commission, preparations must be made to print the literature and distribute it in sufficient time. Similarly, in the case of issuance of securities, time is of the essence and easy access to the staff for purposes of prompt correction is necessary. The field staff's constant reiteration that the matters must be checked and approved in Washington may often prove irritating to the individual involved - particularly in view of the characteristic nervousness that marks financial transactions against a dead-line, and especially when Washington imposes last minute requirements. The high degree of centralization is probably responsible for the charge of "red-tape" which is sometimes levelled against Commission procedures. Further, it is inevitable that there should appear some evidences of a bottle-neck which involves delay. And, finally, it is

asserted by some that the process of remote decision on interim problems which centralization entails results in a certain degree of inflexibility and lack of reality marking the decision: Abstract considerations are likely to outweigh the important factors of individuality involved in the particular course chosen by the field staff.

While there is doubtless some truth in these charges, there is another side to the picture. There must, of course, be a uniform policy, and a uniform policy can be achieved only through contact with and continuous supervision by a central authority. Local peculiarities and conditions are not likely to mark the bulk of the type of work facing the Commission. Further a major objective of the Acts is the accumulation and disclosure of information; accordingly, Washington has become the reservoir for vital data from which must flow particular decisions and activities. Decision making must necessarily be in propinquity to the fountain-head of data. In addition, it has long been felt that to permit field autonomy would involve the unfortunate result of just a other type of centralization: Centralization in New York - a phenomenon which long provided difficulties to the Federal Reserve System. It is felt to be particularly undesirable, in addition, to have too much control centered at the site of the activities regulated: A geographical separation between the regulator and those regulated is felt to be more likely to achieve dispassionate consideration.

It is difficult to suggest a practical and concrete arrangement whereby the conflicting considerations can be given their proper weight. On the one hand, centralization achieves one of the major purposes of the administrative process: Uniform treatment of a national problem by a single group of specialists. On the other hand, it militates against the complete realization of a second major objective of the administrative: Flexibility and expedition. It may, however, be fairly expected that as the assimilation of the field staffs to the organization as a whole becomes complete, and as the Commission policies become crystallized, there will be some shift of intermediate if not ultimate control from Washington to the field. And, indeed, it is to be noted that very recently, a step in this direction was taken by the Commission. On June 12, 1940, through Securities Act Release No. 2279 and Securities Exchange Act of 1934, the Commission announced the establishment of what it termed an "experimental unit" in its San Francisco regional office. The stated purpose of the unit is to "assist prospective issuers of securities and to furnish advice, both legal and accounting assistance are to be offered. Advice given by the regional unit will not be binding in the Commission itself; nevertheless the experiment will make available an examining group in San Francisco which will be able to perform some of the administrative functions heretofore confined to Washington.

Miscellaneous duties of the Commission. Besides its functions in respect of permitting registration statements to

become effective, adjudication, and issuance of rules and regulations, discussed below in Parts II and III of this Monograph, the Commission has a variety of other duties. As already described, it acts in an advisory capacity and participates as a party in reorganization proceedings in federal courts under Chapter X of the Bankruptcy Act.<sup>29</sup> Further, the Commission is responsible for investigations, litigation in the courts, and preparation of criminal cases. In addition, at the direction of Congress, the Commission has engaged in extensive investigations which included (1) the Protective Committee Study, under Section 211 of Title II of the Exchange Act, leading to a seven volume report and contributing substantially to the enactment of Chapter X and the Trust Indenture Act; (2) the Investment Trust Study under Section 30 of the Holding Company Act, as a result of which several volumes of reports have been issued and legislation is now pending; (3) a study of the feasibility and advisability of the complete segregation of the functions of dealer and broker under Section 11 (c) of the Exchange Act; (4) a study of the rules of national securities exchanges with respect to the classification of members, the methods of election of officers and committees, and the disciplining of members under Section 19 (c) of the Exchange Act; and (5) an investigation regarding the making, performance, and costs of services, sales and construction contracts with holding

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29. As of December 13, 1939, the Commission was a party to 106 proceedings under Chapter X for the reorganization of 129 corporations. SEC Corporate Reorganization Release No. 18.

companies' subsidiaries and public-utility companies, "the economies resulting therefrom, and the desirability thereof", under Section 13 (g) of the Holding Company Act. Finally, under Section 11 (f) of the Holding Company Act, the Commission is expressly authorized to act as sole trustee or receiver for any registered holding company or subsidiary in any proceeding in a court of the United States. The Commission has never acted in such capacity, and in the case of the reorganization of the Associated Gas and Electric holding company system, it recently expressly notified a federal judge of its unwillingness to act as trustee in that case.

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Statistics concerning the work of the Commission.

The enormous work-load of the Commission under the several Acts may be indicated by the following figures: During the life of the Securities Act up to December 31, 1939, 4,275 registration statements covering approximately \$19,500,000,000 of securities were filed. As of June 30, 1939, financial information in the form of periodic reports concerning 4,252 issuers had been filed under the Exchange Act in connection with the registration of securities on national securities exchanges. Under the Exchange Act, the Commission has registered, and exercises a continuing supervision over 20 national securities exchanges with a total of approximately 3,400 regular members trading in the securities of more than 3,170 issues.

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30. For a more complete compilation of the work of the Commission, the type of cases handled, and their disposition, see Appendix C, pp. 329-337.



As of December 31, 1939, registered over-the-counter brokers and dealers totalled 6,679. As of June 30, 1939, the Commission exercised jurisdiction over 51 public utility holding company systems, comprising 142 registered holding companies and 1,524 individual holding, sub-holding and operating companies, the total consolidated assets of which amounted to more than \$14,000,000,000. As of December 13, 1939, the Commission was a party to 106 proceedings under Chapter X, involving the reorganization of 129 corporations.

## II

### ADJUDICATION

In general. Roughly, the Commission's adjudicatory activities fall into three categories: (1) Approval, permitting to become effective approval of applications or statements required prior to the doing of certain acts or series of acts - a function somewhat analagous to licensing and so referred to herein for purposes of convenience only; (2) declarations of status, including granting or denying applications for exemptions from the operations of the several Acts, or particular sections thereof; and (3) disciplinary and regulatory action. Included in the first category described as licensing are (a) permitting or refusing to permit registrations of securities to become effective under the '33 Act (although it is important to note that permitting a statement to become effective is a negative process, and not an affirmative order; it is simply inaction which has certain consequences and is not strictly and "adjudication" at all); (b) permitting or denying registration of securities for trading on an exchange under the '34 Act; (c) granting or denying applications for continuance of unlisted trading privileges (i.e., trading in a security not registered on an exchange) or for termination thereof; (d) granting or dismissing applications to withdraw or strike a security from registration on an exchange; (e) granting or denying registration to a securities exchange or to a securities association; (f) permitting or denying registration of broker-dealers and

(g) granting or denying permission to engage in various specific transactions (see supra, pp. 8-11) under the Holding Company Act. The second category - declarations of status - is one coming into play particularly under the Holding Company Act, and includes exemptions, upon application, of various types of holding companies and subsidiaries, and orders, both upon application and upon the Commission's own motion, declaring that, for example, particular companies are or are not electric or gas utilities within the meaning of the Act, or that persons are or are not holding companies, affiliates or subsidiaries. In the third category, "disciplinary action", in the main, is closely connected with "licensing" in that it includes revocation of licenses in the form of stop orders (i.e., suspending the effectiveness of a registration statement) under the '33 Act; or delisting securities registered for trading on an exchange; or suspending or revoking the registration of a national securities exchange; and of revoking a broker-dealer registration. In addition, "disciplinary action" includes a few orders not, in effect, revocation of licenses: The Commission, for example, may suspend or expel a member or officer from a national securities exchange. "Regulatory action" on the other hand, includes orders looking toward the simplification and integration of holding company systems under the Holding Company Act. Finally, under the recently enacted Maloney Act, the Commission is vested with the novel, if hybrid, function of acting as an appellate or semi-appellate body to review disciplinary measures

taken by a national securities association against members or  
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prospective members.

In their broad outlines, the Commission's procedures follow the orthodox patterns: (1) In the case of licensing and the bulk of the exemptions and declarations, initiation of action by application; (2) investigation; (3) complaint or other notice of hearing; (4) hearing; (5) trial examiner's report; (6) perceptions thereto, with briefs and oral argument; and (7) decision and order. But peculiar and practical considerations, as well as statutory provisions, have resulted in the omission of some steps and the addition of others, especially in respect of registration statements. In registration of securities under the '33 Act, steps (3) to (7) are omitted unless formal proceedings are instituted with a view toward the issuance of stop or refusal orders; in cases begun by application under the Holding Company Act, steps (5) and (6) are normally waived; and in almost all proceedings, there is extensive utilization of informal steps preceding and interspersed with the formal ones.

Finally, two vital characteristics mark the work with which the Commission is faced and the recollection of which is necessary to obtain a proper picture of its adjudicatory activities. The first is that the Commission is in large part a

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31. Since this function sharply contrasts with the usual administrative procedures for adjudication, description thereof is reserved for a separate section, infra, pp. 270-273. For a more complete compilation of the adjudicatory functions of the Commission, see Appendix A, pp. 305-316.

supervisory licensing or authorizing agency rather than a policing agency issuing cease and desist orders; although, indeed, some of its work, as already noted, involves proceeding against individuals, the bulk of its time is devoted to granting privileges and permitting activities to be engaged in and transactions to be consummated. The second characteristic, related to the first, lies in the dynamic subject-matter with which the Commission is dealing: In the case of registration of securities under the '33 Act, as well as in the case of issue, sale, and acquisition of securities under the Holding Company Act, speed and timing, as already noted in another connection (supra, p.24), are of the essence. Since the Commission is a dispensing agency, and since its dispensations in these types of cases, if they are to be of real use and significance at all, must be forthcoming promptly, there must often be considerable departure from orthodox procedures and formal patterns. Where an underwriter's deadline must be met, or a favorable market caught, it is inevitable - and proper - that there be resort to what may be called the "after-hours" method of decision. Staff members, and the commissioners, must be available for quick and informal decision; especially in questions of registration of securities, flexibility which permits of quick staff conferences, telephonic decisions, and the like, is necessary. In short, in cases of this type, the method must, if the agency is to be effective, differ sharply from the slower bodies which are confined to the realm

of purer and more insulated final adjudication. 32

Preliminary Procedures in Cases Begun by Application

Persons who may invoke official action. Official action leading to the approval or disapproval of the various licenses or permits to engage in certain transactions or types of businesses is ordinarily invoked by persons directly affected in that they are the persons seeking to engage in such activities. Thus, a registration statement under the '33 Act may  
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be filed by the issuer of the security sought to be registered.

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32. It is pointed out that the procedures for handling securities' registration statements were devised by the Federal Trade Commission and thereafter developed under the aegis of the Commission's first chairman, Joseph Kennedy, who was himself an experienced securities dealer. Through the Chairman (and underwriters, accountants and others familiar with the practical operations who were brought to Washington to assist) effort was made to cut the procedures to fit the practical requirements of the business with which the Acts dealt.

33. Section 2 (4) of the Securities Act defines an "issuer" as "every person who issues or proposes to issue a security; except that with respect to certificates of deposit, voting trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors (or persons performing similar functions) or of the fixed, restricted management or unit type, the term 'issuer' means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; except that in the case of an unincorporated association which provides by its articles for limited liability of any or all of its members, or in the case of a trust, committee, or other legal entity, the trustees or members thereof shall not be individually liable as issuers of any security issued by the association, trust, committee, or other legal entity; except that with respect to equipment trust certificates or like securities, the term 'issuer' means the person by whom the equipment or property is or is to be used; and except with respect to fractional undivided interests in oil, gas, or other mineral rights or of any interest in such right (whether whole or fractional) who creates fractional interest therein for the purpose of public offering."

or, if the security is issued by a foreign government or political subdivision thereof, by the underwriter of such security.<sup>34</sup> Similarly under the Exchange Act, applications for registration may be filed by the various persons for whom registration is required; securities exchanges, issuers of securities, brokers and dealers wishing to do business in securities over the counter, the national securities associations and affiliates thereof, each may make applications. While only a national securities exchange may apply for the continuance or extension of unlisted trading privileges (i.e., permission to deal in securities which have not been registered for trading on such exchange), applications for the termination or suspension of such privileges may be filed by a broader group which includes the issuer of the security involved, any broker or dealer who makes or creates a market for such security (over the counter), or "any person having a bona-fide interest in the question of termination or suspension."<sup>35</sup> In the case of registration of securities for

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34. As noted more fully below, the filing of registration statements, as well as several other types of applications, is not a request for decisive administrative action but rather a request that no adverse action be taken so that the registration or other application will become effective. See infra, pp. 54-56.

35. Brokers and dealers may have a competitive interest in unlisted trading privileges. If a security is unregistered and unlisted trading privileges are absent, the security will be dealt in over-the-counter by broker-dealer specialists. The conditions under which their application will be granted are set out in Rule X-12F-3. Since no application has yet been filed by persons "having a bona fide interest", the phrase has not required definition. Presumably it includes a person who owns a controlling interest in the security involved.

trading on an exchange, the application involves two stages: The initial application is by the issuer, but it is made to the exchange, with copies submitted to the Commission; official action is not invoked until the exchange upon which the security is sought to be registered certifies to the Commission that the security has been approved by it. Either the exchange or the issuer may apply for withdrawal or striking of a security from listing and registration.

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In the main, persons directly affected comprise the class which may invoke official action under the Holding Company Act. Such persons include public utility and registered holding companies, subsidiaries, associates, affiliates, mutual service companies and member companies thereof, and underwriters. In general the action is invoked by the particular person seeking to engage in the operation or transaction under consideration, or whose status is involved. Either a holding company or its subsidiary may apply for an exemption of a subsidiary under Section 3 (b) and Rule U-3B-1, and, similarly, applications for a declaration that a company is not a subsidiary company of a specified holding company under Section 2(a) (8) may be filed

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36. An exchange's application to delist may often be a disciplinary measure against the issuer. The exchange's procedure for making such application is indicated by In the Matter of Hupp Motor Car Company, 1 SEC 177 (1935), in which the New York Stock Exchange applied for such delisting. The opinion indicates that the application was made upon resolution of the Governing Committee of the Exchange following an investigation by its Committee on Stock List. The investigation included the taking of testimony and the recording thereof.



either by the latter or by the company which claims not to be a subsidiary. Applications for a declaration that the applicant is or is not an electric or gas utility company within the meaning of the Act may be made either "by the company in respect of which the order is to be issued or by the owner of the facilities operated by such company." In two instances under the Holding Company Act, a somewhat broader class of persons may invoke official action: (a) Under Rule U-11F-1 (a), applications for approval of a reorganization plan for a registered holding company or subsidiary thereof may be filed by "any person having a bona fide interest in such reorganization;" Rule U-12E-1 (e) provides that the following persons shall be deemed to have a "bona fide interest": (1) the company involved,<sup>37</sup> any creditor or stockholder thereof, any receiver or trustee of such company and any duly authorized representative of any of such person, (2) any trustee under a mortgage, deed of trust, or indenture

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37. An interesting and difficult problem in respect of whether an unregistered company can apply for approval of a reorganization plan was raised by In the Matter of The Application of International Paper and Power Company, 2 SEC 274 (1937). The company applying for approval had not been registered, but had applied for an exemption as a holding company under Section 3 (a). The application for exemption had not yet been passed upon by the Commission, nor had any declaration been made as to whether such application had been filed in good faith (an application filed in good faith entitles the applicant to a temporary exemption pending final determination). Nevertheless, the company applied to the Commission for approval of a reorganization plan. The Commission held, Commissioner Healy dissenting, that it had power to approve a report on the plan although the company was unregistered. The majority grounded its decision on the practical predicament in which the applicant would be placed if the Commission refused to act. It pointed out that

pursuant to which there are outstanding securities which have been issued, guaranteed, or assumed by such company; (3) any State commission having regulatory jurisdiction over the company undergoing reorganization, or any person authorized to prepare a plan by any court, officer, or agency before which a reorganization proceeding is pending; and (4) any other person who is declared by the Commission, to have a bona fide interest in such reorganization, including (but without limitation) consumers, officers, directors, or employees of such company, labor unions, associations, and other representatives of such employees.

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(b) A State commission may apply to the Com-

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37. (Cont'd) the number and complexity of applications for exemption made it impossible and inadvisable to adjudicate them rapidly; yet the plan of reorganization contemplated the issuance of warrants to purchase common stock, and of another class of stock convertible into common stock. If the application for exemption were to be denied in the future, the issuance of the common stock, and the conversion, would be subject to Commission approval; thus, because the exemption was yet to be passed upon, there would be a cloud upon the common stock to be issued. The Commission discussed various other possible courses of action, all of which it concluded would not be fair to the company or the security holders. Appealing to the general flexibility of the administrative process as the escape from a hiatus left by the legislature, and stating that "To interpret our powers under our fundamental Act with undue strictness at this stage in our growth would be to sacrifice upon the altar of a by-gone legal formalism our ability to perform adequately our allotted task", the majority passed upon, and approved, the plan. Commissioner Healy dissented on the ground that the Commission lacked power or jurisdiction to act, because the applicant was unregistered. His position was upheld in Lawless v. the Securities and Exchange Commission, 105 F. (2d) 574 (C.C.A. 1st, 1939); the Court held that the Commission was without power to "extend the benefits" of the Act to unregistered companies.

38. No applications have thus far been filed by persons in category (4).



mission for an order requiring reallocation or reapportionment of costs among members of a mutual service company, or for an order eliminating a service or services to a member company under Section 13 (d).

Method of invoking official action. Official action in respect of permission to engage in the various transactions or businesses treated by the Acts is invoked by the filing of formal papers<sup>39</sup> in the form of applications (e.g., for registration as a broker-dealer, for extension or terminations of unlisted

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39. Not infrequently in the case of the filing of registration statements under the '33 Act and especially in the case of applications and declarations under the Holding Company Act, conferences between the Commission's staff members and the registrant, applicant or declarant, precede the filing of any formal requests and, indeed, may shape the form and nature of such requests. Where important transactions are contemplated under the Holding Company Act - a recent refunding operation involving \$132,000,000 whereby an intermediate holding company (itself a subsidiary) was to be collapsed out of the system is an example - the problems are discussed in detail and the issues are explored long before the application is filed. When filed, it reflects the plans mutually evolved by the staff and the applicant. Further, it is to be noted that under the Holding Company Act, the initial stimulus for filing an application may come from the Commission's staff itself. As noted below, each group in the Utilities Division is assigned to a few utility systems over which they keep continuous watch; accordingly, the staff may deem it advisable for a particular company to enter into particular transactions, suggestion will be made, and application thereafter filed. Pre-filing conferences do not stop the Commission from subsequently denying the application or attaching conditions and reservations to the approval thereof. In the Matter of Columbia Gas & Electric Corporation, 4 SEC 406 (1939).

trading privileges, for acquisition of securities under the Holding Company Act, and for the several exemptions and declarations of status under the Act) or declarations (in the case of the issue and sale of securities under the Holding Company Act). Under the Securities Act, administrative action is invoked by the filing of the registration statement itself (in the case of ordinary securities), or the "offering sheet" (in the case of the sale of fractional undivided interests in oil or gas rights), or the "prospectus" (in the cases of the sale of interests in an oil royalty or similar type of trust). As already described, action concerning registration of a security for trading on an exchange is begun by the filing of the application for registration and the certification by such exchange that it has approved the registration. Applications for confidential treatment of contracts or other material which would otherwise be required to be included in a registration statement or other information or report is made by the omission of the material claimed to be confidential, the separate filing of such material marked "confidential", and written objections to the disclosure thereof.

With the exceptions noted immediately below, elaborate provisions are made for the filing of the several applications, statements and declarations upon forms prescribed by the Commission's rules and regulations. Thus under the Securities Act, different forms are utilized not only for different classes

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of issuers but also for different types of securities. Similarly, 22 different forms are prescribed for registration of securities under the '34 Act, and 15 forms are provided for the filing of annual reports and other periodic information. 41

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40. See Guide to Forms Adopted Under the Securities Act of 1933, issued by the Commission to aid prospective registrants in determining what form should be used under the particular circumstances pertaining to their proposed offerings. For a vivid account of the procedure which a registrant's attorney must utilize in the course of preparation of a registration statement, see Dean, The Lawyer's Problem in the Registration of Securities (1937) 4 Law and Contemp. Prob. 154.

41. See the Commission's Guide to Forms Adopted Under the Securities Exchange Act of 1934. The several forms under both Acts are intended to be so devised as to fit the particular categories of companies and issuers with which the Commission deals, and differences in forms are intended to meet differences in issuers and, as a matter of convenience to such issuers, to require only such information as is immediately applicable and pertinent to the particular type of situation. Thus, obviously different forms are required, for example, for (1) and ordinary corporation; (2) a reorganization committee; or (3) an issuer of undivided fractional interests in oil or gas rights. See Neff, Forms for Registration of Securities Under the Acts of 1933 and 1934 (1938) 51 Harv. L. Rev. 1354.

The Commission has endeavored to insist upon intelligibility in the answers prescribed in the registration forms. E.g., Regulation C, Rule 500. But compare, "The forms adopted . . . call for a large amount of statistical and historical information. As the Act imposes a civil penalty on any false or misleading statement made in connection with a registration, those applying for a registration have tended to quote original documents instead of employing brief and enlightening summaries. This has resulted in unduly voluminous registration statements which are of little practical value except to the expert analyst. The Commission has recognized the difficulty created by verbose statements and has endeavored in the administration of the Securities Exchange Act of 1934, as well as in the administration of the Securities Act of 1933, to persuade applicants for registrations to summarize their replies and to use non-technical forms. Little progress, however, has been made in this direction." Redmond, op. cit. supra, note 19, 629-630.

In general, it may be noted that a distinction obtains in respect of the purposes of registration forms and forms for application, and, consequently, the two are treated somewhat differently.

In the case of the former, the purpose is public disclosure, accordingly, there is more or less rigid insistence upon strict adherence to the form. Applications, on the other hand, serve as pleadings and as a pre-hearing indication of the statistical and factual evidence to be presented upon which action, after hearing, is to be predicated; through applications and amendments thereto, the matters to be adduced at the hearing can be confined to specific areas. As a result, form in the case of applications is of less importance and the hearing may serve to complete and develop the matters presented in the applications.

Complete rigidity has been avoided by the Commission in its utilization of forms for the several applications. Regulation C, Rule 410, relating to registration statements under the '33 Act expressly provides that "Any statement shall be deemed to be filed upon the proper form unless objection to the form to be filed upon the proper form unless objection to the form is made by the Commission prior to the effective date of the state-<sup>42</sup>ment." Nor are applicants under the Holding Company Act strictly bound by the form of application which they utilize. Thus, for example, an application filed by a registered holding

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42. "The registrant is not required to use a printed form supplied by the Commission. If such printed form is not used, however, it will be necessary to type or print a complete statement containing all items in the form and the answers thereto." Regulation C, Rule 411.

company for approval of acquisition of securities under Section 10 may be treated as an application for the exemption of such a transaction under Section 9 (c) (3) if sufficient facts are set out in the application.<sup>43</sup>

The rules under each of the three Acts require that the registration statements, applications, declarations, and other papers, as the case may be, must be delivered to and filed with the Commission in Washington. There is no machinery for formally initiating action through the regional offices except under Regulation C, Rule 921, which provides that "a registration statement [filed under the '33 Act] containing information substantially the same as that contained in an earlier registration statement filed with the Commission by the same issuer may be filed in any regional office of the Commission: Provided, that it is so filed within ninety days after the effective date of such earlier registration statement." Even this small concession to decentralization has not been utilized, chiefly because the situation covered by the rule is so rare as to make it academic.

With two exceptions, applications or other requests for action need not be verified. Rule X-12D2-1 (b) (1) (A) under the Exchange Act provides that "An application by an issuer or an exchange to withdraw or strike a security from listing and registration . . . shall be signed and sworn to by

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43. E.G., In the Matter of the Middle West Corporation, 2 SEC 694 (1937); In the Matter of South Carolina Utilities Co., 3 SEC 362 (1938).



an officer of the applicant authorized to do so . . ."; and Rule U-2 (d) of the Holding Company Act similarly requires that "Every application for an order under any provision of the Act, for which a form with instructions is not specifically prescribed and every amendment to such application, and every statement of fact formally filed in support of, or in opposition to, any application or declaration, shall be verified by the person executing the same." Verification is required in these two situations since, as is described below (p. 206), such applications may be submitted into evidence at the hearing and may, in the absence of opposition, constitute the entire record upon which the Commission's order will be issued. Of course, it is to be noted, although other types of applications and registration statements are not required to be verified, false statements therein subject the registrant or applicant to the appropriate civil and criminal sanctions described in a preceding section.

Fees are involved in the invocation of official processes in two situations. Under Section 6 (b) of the Securities Act, "At the time of filing a registration statement the applicant shall pay to the Commission a fee of one-hundredth of 1 per centum of the maximum aggregate price at which such securities are proposed to be offered, but in no case shall the fee be less than <sup>44</sup>\$25." The filing of a registration statement shall not be

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44. "The determination of the adequacy of the fee is made as of the date of filing. Subsequent changes in the proposed offering price either prior to or after the effective date of the registration statement, if made in good faith would not necessitate payment of an additional fee, or, stated alternatively, (Cont'd)

deemed to have taken place unless it is accompanied by a United States postal money order or a certified bank check or cash for the amount prescribed. The fee is not returned if the registration statement is refused an effective date or withdrawn by the applicant (Rule 960). The only other situation in which the payment of fees is required is provided for by Section 31 of the Exchange Act, under which every national (i.e., registered) securities exchange must pay to the Commission on or before March 15 of each calendar year a registration fee for the privilege of doing business as a national securities exchange during the preceding calendar year or any part thereof. The fee must be in an amount equal to one five-hundredths of one per-centum of the aggregate dollar amount of the sales of securities transacted on such exchange during the preceding year and subsequent to its registration as a national securities exchange.

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44. (Cont'd) if the fee paid at the time the statement is delivered to the Commission has been calculated in good faith upon the registrant's then proposed maximum offering price, any later changes in the offering price of the securities would not upset the fee on the filing date. It would make no difference if subsequent to a bona fide calculation at the date the statement was submitted, the registrant because of changed market conditions or other reasons decided to offer at a unit price higher or lower than that upon which the calculation was based. In either event, the registrant would not be obligated to pay an additional fee or entitled to receive a refund of a portion of the fund paid." Johnson and Jackson, The Securities and Exchange Commission Its Organization and Functions under the Securities Act of 1933 (1937) 4 Law and Contemp. Prob. 3, 6-7.

45. Since its creation, the Commission has received a total of \$1,681,723 in fees from registration of securities, and \$1,742,680 in fees from registered exchanges. The receipts for the fiscal year 1939 were \$276,072, and \$278,475, respectively. These sums are not available for expenditure by the Commission, but are deposited in the United States Treasury as miscellaneous receipts.

Official action following receipt of application.

To meet the demands for expedition as well as for intimate and special knowledge which such expedition, in turn, requires, the Commission's staff has been highly organized into several units, each of which is assigned to the initial scrutiny of particular types of applications, registrations, and declarations. There are, accordingly, three major divisions vested with initial responsibility for passing upon these requests: the Registration Division, the Trading and Exchange Division, and the Public Utilities Division. The Registration Division, in turn, is divided into two units, one of which handles registration statements under the '33 Act and the other registration of securities for trading on an exchange under the '34 Act. The former unit is composed of approximately 69 employees, headed by two active Assistant Directors. In the '33 registration unit, there are five examining groups, each with an analyst, who is chief of the group, two or three attorneys, five or six examiners, and one or more accountants. For these five groups, there is no special breakdown by type of company or type of registration statement: Rather the work of each is similar to the work of the other. In addition, the '33 registration unit has an Oil and Gas Unit, which handles oil and gas offering sheets and prospectuses, a Mining Unit, handling registration of mining securities, and an Engineering Unit which serves the other units when the occasion arises. The '34 registration unit is composed of 68 employees, including stenographers and clerks. Even more highly organized than the '33

unit, it is divided into nine groups, each headed by an analyst, each including a reviewer and two or three examiners, but with only two attorneys for all the groups. Each group is assigned about 300 companies which are as closely related as possible, first through corporation relationship (parent and subsidiary), and second by industry.

In the Trading and Exchange Division only the unlisted securities unit and the over-the-counter unit have functions which need be described here.<sup>46</sup> The unlisted securities unit, composed of two attorneys, one analyst and two stenographers, is concerned with matters arising under Sections 12 (d) and 12 (f) of the Exchange Act: Applications by issuers of securities and by exchanges for withdrawal or striking of securities; applications by exchanges for extension of unlisted trading privileges; and applications by issuers and others to terminate such privileges. The over-the-counter unit deals with the registration of brokers and dealers and the supervision of trade practices and the like under the Exchange Act. The unit comprises approximately 58 persons, including attorneys, accountant investigators, and professional clerks (registrars and analysts). The unit has three subdivisions: (1) the registration group, which examines the registration applications; (2) attorney investigators; and (3) "reporting" Attorneys.

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46. The only formal proceeding thus far handled by the securities association unit is described below, pp. 270-278.

Primary responsibility for administering the Holding Company Act rests in the hands of the Public Utilities Division, which consists of approximately 120 attorneys, accountants, analysts and engineers, together with secretarial and other assistants, bringing the total personnel of the Division to approximately 180. Formerly there was a tendency toward functional specialization with specialized groups for the handling of such matters as exemptions, service companies and integration. Following a recent reorganization of the Division, most of the personnel of the special groups has been transferred to nine examining units, each headed by a supervising analyst, assisted by a senior attorney, each unit being assigned two to four holding company systems. These groups comprise 80% of the attorneys, accountants, analysts and engineers of the Division; the remainder are available for special research, executive and administrative work, and as special consultants and coordinators with respect to matters formerly handled by special groups such as exemptions, Section 13 matters, research, accounting, engineering, drafting and interpretation of rules.

Examination and investigation. In general, the flow is from the examining or other subordinate groups through the head of the examining group, the Assistant Director, and to the Director. In the case of the '33 registration unit, which, while larger and somewhat more complex than the other units, is nevertheless typical, a registration statement upon being filed is given a file number for purposes of identification; the even-

numbered state,ments are under the supervision of one Assistant Director, the odd-numbered under the other. The registration statement is assigned to an analyst, who, in turn, assigns a copy to an examiner, an accountant, and an attorney in the group. It is the examiner's duty to determine whether the statement is filed on the proper form and whether the information accords with the formal requirements of the Act and the rules and regulations. He also scrutinizes the statement to assure himself of its intelligibility and clarity. The attorney and accountant examine the statement from the legal and accounting point of view, respectively.

Upon the basis of such examination, a memorandum, the "Initial Report by the Examining Group", is prepared by the examiner. It includes in brief form a history of the issuer, a statement of the capital structure, a statement of the securities proposed to be offered, the price thereof and the underwriting data, a statement of the securities, if any, proposed to be offered at a price below the public offering price, options to persons other details as the occasion requires, and, finally, a memorandum of the material questions raised and the deficiencies noted. The report and memorandum are submitted to and reviewed by the attorney and accountant and discussed by the group, signed by them, and then submitted to the appropriate Assistant Director.<sup>47</sup>

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47. For a description of this entire process, see Johnson and Jackson, op. cit. supra, note 44, pp. 12-14.

Where necessary, the examination of the applications is supplemented by informal field investigation through the Commission's regional offices.<sup>48</sup> As a regular routine practice, experts in the Oil and Gas Unit tour the country examining oil and gas properties, collecting and filing information. In ordinary registration statements, there may also be filed inspection, although limitations of time require the reservation of extensive and formal investigation for cases in which refusal or stop orders are considered a possibility (see infra, pp. 86-96). In cases involving applications for registration as a broker or dealer, it is customary for the Over-the Counter Unit immediately to send to state securities commissions, better-business bureaus, and the like, notice of the application, in order to discover whether the applicant has run afoul of local laws; in addition, extensive files on brokers and dealers have been compiled by the Commission.

Granting without a hearing. (1) Statutory provisions.

Under both the Securities Act and under the Exchange Act, in accordance with the statutory provisions, applications and registration statements automatically become effective at the end of stated periods in the absence of affirmative action by the Commission.<sup>49</sup> Thus in respect of registration statements under the '33 Act, Section 8 (a) thereof provides that in the absence of amendments or the bringing of a refusal proceeding

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48. For a more extended description of formal investigations preceding decisive action, see infra, pp. 86-92.

under Section 8 (b), or a stop order under Section 8 (d), "The effective date of a registration statement shall be the twentieth day after the filing thereof," or in the case of registration statements pertaining to securities issued by certain foreign authorities on the seventh day. In the case of offering sheets for oil and gas interests exempt from registration under Section 3 (b), the effective date is eight days after filing; while ten days may elapse before a prospectus for similarly exempt interests in an oil royalty or similar trust becomes effective. Registration of securities for trading on an exchange under Section 12 (d) of the Exchange Act becomes automatically effective 30 days after the Commission's receipt of certification by the exchange involved; registration of an unissued warrant or other unissued security for "when issued" trading becomes effective the sixth day after filing with the Commission or the second day after the receipt by the Commission of the exchange's certification. Applications for registration filed by a broker-dealer under Section 15 (b) of the Exchange Act result in effective registrations, in the absence of action by the Commission, thirty days after receipt of application.

Thus, since only a very small number of registration  
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statements or applications under these Acts are denied, it will

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49. Discussion concerning the current policy of holding hearings upon applications and declarations under the Holding Company Act is reserved for a subsequent section, infra, pp. 59-80.

50. See Appendix C, pp. 29-331. Applications for confidential treatment under the '34 Act comprise an exception to this general statement: A majority of such applications are denied.



be noted that the vast majority of them become effective without formal hearing.

(2) Procedure for granting without a hearing:  
informal methods of correction. Although the Acts provide only (1) for the automatic effectiveness, after a prescribed period, (subject to the Commission's power to accelerate the period, infra, pp. 61-66) of the different types of registrations, and (2) for the institution of decisive proceedings to deny, the Commission has adopted a number of informal devices for avoiding denial or revocation, obtaining proper correction of defects in the registrations, and, thus, permitting them to become or remain effective, as corrected, without a formal proceeding and hearing.

The major device for achieving this is the "deficiency letter", employed most often by the Registration Division. On the basis of the memorandum prepared by the examining group, a letter is prepared pointing out to the registrant not that the representations in the statement are untrue or misleading, but simply that on the basis of the mass of data which the Commission has on file, certain specified material appears to be untrue and misleading or certain information required seems to be omitted. Ordinarily, the examination of a registration statement consumes about ten days; accordingly, there is sufficient time (ten days) to prepare and send the letters. If the registrant responds with a correcting amendment, the 20-day period commences to run anew from the date of filing the amendment subject to its being but off by virtue of the Commission's power to accelerate.

As a rule, therefore, it is possible to shape the registration through a deficiency letter, or, if the amendments themselves are unsatisfactory, through a series of such letters. In fact, however, one or at the most two, letters are usually sufficient to obtain the desired corrections. In the last fiscal year, although only 20% of the statements filed needed no deficiency letter, each registration statement averages only one and a half amendments in response to such letters. Because the securities proposed to be sold must be offered at a desirable time, and because the public notice which would precede decisive proceedings would make successful public sale difficult, it is not surprising that the deficiency letter has proved to be an extraordinarily effective method of clearing up defects and permitting the statement to become effective: it is to be noted that only six stop order proceedings were initiated in the last fiscal year although 375 were filed.

Thus it may be observed that although in terms the Acts seem to offer only a choice between automatic effectiveness upon the lapse of the statutory period or complete ineffectiveness through formal proceedings, the Federal Trade Commission created (and the Securities and Exchange Commission subsequently further developed) effective informal machinery to permit effectiveness without a hearing yet without impairing the policy of full disclosure.<sup>51</sup> For the vast bulk of administrative action taken in respect of registration statements is achieved

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51. See Johnson and Jackson, op. cit. supra, note 44, pp. 10-11.

not through formal proceedings, but through deficiency letters supplemented by conferences. As has been observed by a former chairman of the Commission:

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"The major reforms in regard to underwriting practice, corporate disclosure, and accounting techniques that the Commission has brought about . . . are not of public record. The trend of decisional policy is not readily discoverable from the stop order opinions of the Commission. The nature of these reforms can only be found by an examination of the successive amendments made by issuers of securities prior to the effective date 53--- amendments made in the hope that the corrected form of disclosure will avert the bringing of a proceeding."

But once the general policies have been set by the Commission through formal decisions and through conferences with the staff there has been an almost complete delegation by the Commission to the staff in respect of administering the policies thus blocked out. The units in the Registration Division have autonomy in preparing deficiency letters, except, of course, for a general residual supervisory power retained in the Commission itself. Such letters are prepared by the examining group and accompany the "Initial Report" described above (p. 54). The letters are cleared through the Assistant Director and

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52. Landis, op. cit. supra, note 8, p. 109.

53. About twenty per cent of the registrations of securities for trading or exchanges under the '34 Act clear through in the thirty-day period without notation of deficiencies; a similar percentage is said to obtain in respect of '33 Act registrations. The percentages have increased steadily as the registrants, lawyers, accountants, and others have become familiar with the Commission's requirements.

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Director, and are sent out over the signature of either one. If the staff disagrees concerning the fact of deficiency or concerning the question whether the amendment cures the deficiency, case will go to the Commission. A similar course through the hierarchy is available in the event that the registrant takes issue with the deficiency letter: He may confer with the examiner, the Assistant Director, the Director, and, if still dissatisfied, with the individual commissioners themselves. Consonant with its general policy of centralization already discussed, however, deficiencies cannot be passed upon by the regional employees: Although they may confer with registrants and transmit suggestions for corrections, all amendments and negotiations leading thereto are subject to final approval by the Registration Division in Washington. That this may often prove irritating to registrants racing to meet a dead-line seems to be clear. Some have complained that they have found it necessary, at the suggestion of the regional staff, to develop material which the Washington office later decided was unnecessary, or on the other hand, that they have checked their statements through the field office, prepared themselves for the

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54. In the case of letters concerning '33 Act registration statements, the letter is sent to the registrant or an agent designated by him for service. In respect of '34 Act registrations of securities for trading, it was formerly the practice, if trading on the three largest exchanges was involved, to address the letters directly to such exchanges and to look to them to obtain corrections. At the request of the exchanges, the practice was abandoned and deficiency letters are now directed immediately to the registrants.

final flotation, and then found that the Washington staff has decided to require a whole new field to be explored. Again, in situations of this kind, it may be desirable to permit some measure of autonomy to be vested in those employees who are immediately available to the registrant as soon as, and if, the basic policies become crystallized and the staff becomes familiar therewith; there is considerable reason to believe, however, that the necessity of maintaining a central source of information makes this desideratum practically impossible of realization.

(3) Determination of subsidiary problems in relation to granting without a hearing; acceleration and deferring of effective dates; applications for confidential treatment. In addition to the main problem of whether to permit a registration to become effective, the Commission is faced with the determination of a number of subsidiary issues concerning the effective date of such registrations. Thus, Section § (a) of the Securities Act provides that "If any amendment to any [registration] statement is filed prior to the effective date of such statement, the registration shall be deemed to have been filed when such amendment was filed; except that an amendment filed with the consent of the Commission, prior to the effective date of the registration statement, or filed pursuant to an order of the Commission, shall be treated as apart of the registration statement." Under this provision, in other words, the filing of an amendment begins the running of the 20 day period anew unless the

Commission consents to acceleration. While perhaps on its face an issue of no great importance, in fact, because of the exigencies of time which mark all such transactions, the question of acceleration is often of considerable moment to the registrant.<sup>55</sup>

Virtually every registration statement under the '33 Act is necessarily filed incomplete: the registrant leaves certain matters (for example, the offering price) to be filled in by amendment. When either completing, or correcting amendments are so submitted, they are almost always accompanied by a request for acceleration under Section 8 (a). The examining group which scrutinizes the registration statement as amended reports hereon and at the same time reports upon the request for acceleration: The determination is made without hearing and, except in rare instances where as a matter of grace the registrant has been permitted to confer with the Commission, the process is wholly internal. The memoranda and recommendations are transmitted to the appropriate Assistant Director and then to the Director of the Registration Division. Finally, the issue

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55. "Inasmuch as underwriters do not like to carry commitments for any longer period than is necessary and since the time factor is of tremendous importance in the success of an issue, it is essential that amendments be cleared as rapidly as possible and their consent obtained to the filing thereof. Otherwise the filing of each amendment (and delay usually causes changes in the public offering price) would start a new twenty-day period running again, so that, unless the consent of the Commission be obtained, the statement would never become effective." Dean, op. cit. supra, note 40, p. 168, footnote 29.

is presented to a single commissioner - whichever one happens to be available at the moment, although formerly one particular commissioner customarily considered acceleration problems; if the latter is in doubt; the matter will be referred to the entire Commission. How far or how thoroughly the commissioner explores the issues, and what phases he explores, depends largely on the time available, the complexity of the problem, and the particular commissioner.<sup>56</sup> Applications for acceleration are usually granted unless the amendments themselves appear defective or unless the amendments are major and are filed too late for proper consideration: in the last fiscal year, all but 10%<sup>57</sup> of the requests were granted.

In contrast to the Securities Act, amendments to registrations of securities for trading on an exchange under Section 12 (d) of the Exchange Act do not affect the 30-day

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56. The recommendations of the staff are normally followed by the commissioner. In view of the speed required, of the difficulty of deciding the request without a knowledge of the full history of the registration statement involved, and of the several hands (examining group, chief analyst, Assistant Director, and Director) through which the request and recommendation have already passed, it would seem desirable to vest discretion in the Registration Division to present only those cases to the Commission where unusual or complex problems are raised. The cumulative total of the Commission's time consumed by routine issues of this sort is considerable, and it is doubtful whether there is full compensating value therefor. Further, it should be noted that a registrant may always confer with one or more commissioners in respect of his request for acceleration.

57. Determination of a request for acceleration is ordinarily unaccompanied by a written opinion. In one early case, however, a request for acceleration was denied and an opinion was written. The Commission held that since the original registration statement and several sets of prior amendments were false, ". . . (Cont'd)

period, but, if filed before the statement becomes effective, the amendments become effective simultaneously with the statement - a method which seems preferable, in view of the need for certainty on the part of the issuer and underwriter, of the heavy burden placed upon the staff by virtue of the arrangement under the '33 Act, and of the necessarily somewhat h<sup>58</sup>ctic procedure required under the latter. Nevertheless, there remains, under Section 12 (d) of the Exchange Act, a problem of acceleration by virtue of the provision that the statement shall become effective 30-days after certification by the exchange "or within such shorter period of time as the Commission may determine."

As in the case of '33 Act registrations, requests for acceleration are frequent. They are determined without hearing and on the basis of the reasons stated in the request therefor. The memorandum and recommendation are prepared by the examining group, and pass through the Assistant Director and Director. Unlike the procedure under the '33 Act, however, the matter is then presented to the entire Commission, although formerly it was the practice for one commissioner alone to assume primary

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57. (Cont'd) there is no good reason why we should advance the date when this registration shall become effective and when the registrant may begin to sell this stock to its present stockholders for whose interests and protection it has acted in this matter with so little caution." In the Matter of Callahan Zinc-Lead Company, 1 SEC 115, 120 (1935).

58. There has been some suggestion that the '33 Act be amended to provide for an automatic five day effective period for amendments to registration statements.



responsibility for the determination of the issues. The standards for granting or denying acceleration requests in '34 Act registrations have been set out by the Director of the Registration Division in a letter addressed to the several exchanges (December 8, 1936): The exchange or the registrant must meet the burden of establishing that (a) an exchange market in the particular case is "not undesirable"; (b) the denial of acceleration would seriously embarrass the operation of the exchange mechanism; and (c) the need for acceleration could not, as a practical matter, have been avoided by reasonably prompt action on the part of the registrant. Although it is stated that "acceleration is to be granted only in the exceptional cases", in fact the Commission's policy in this respect is rather liberal. It is still not uncommon for issuers proposing to offer an additional block of securities of a class already listed and registered on a national securities exchange to register under the '33 Act but to defer filing the application for registration under the '34 Act. Accordingly, last-minute requests are made for acceleration of the effective date of registration under the '34 Act, and since denial would involve considerable embarrassment to the registrant, the exchange and often the underwriter, the acceleration, under these circumstances, will normally be granted.

Under Section 15 (b) of the Exchange Act, relating to the registration of a broker-dealer proposing to engage

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59. The comments set out in footnote 56 seem equally applicable here.

in an over-the-counter business, there arises a problem not only of acceleration but also of déferment of effective date which is the converse of acceleration. Section 15 (b) provides that broker-dealer registrations shall become effective, in the absence of affirmative action by the Commission, 30 days after the filing thereof, and that amendments filed prior to the effective date shall be deemed to have been filed simultaneously with the registration "except that the Commission may, if it appears necessary or appropriate in the public interest or for the protection of investors, defer the effective date of any such registration as thus amended until the thirtieth day of such amendment" (emphasis supplied). As in the case of the procedure relating to acceleration, described above, the issue of deferring under this provision is determined internally and without notice or hearing. Under Section 15 (b), however, the determination is upon the Commission's own motion, and not, of course, upon application therefor. The power is a major one and investigation or examination of the files indicates the existence of grounds for denial. The determination to defer is made by the full Commission upon memoranda and recommendations prepared by the over-the-counter unit.

Three other determinations subsidiary to the main problem of granting or denying must be made in connection with registration statements filed under the '33 Act. The first is the determination of the effective date of amendments filed under Section 8 (c) after the statement has become effective,

but where no stop order proceeding has been brought. This determination is in respect of minor formal matters and is made in the normal case by the Registration Division through the examining group, the Assistant Director and the Director, on the basis of the papers before them. The recommendation of the staff is accepted automatically by the Commission except in doubtful cases especially presented to it. The second determination relates to the dispensing of the requirement of Section 7 that if any appraiser, accountant, engineer, or other expert is named as having prepared any part of the registration statement, his written consent must be filed. Rule 671 of Regulation C provides that the registrant must file an application requesting the Commission to waive the requirement. The issue is ordinarily a simple one, since the request is usually based on the fact that such written consent is unobtainable because of the expert's death or other unavailability. No special order is issued by the Commission; the request, which normally is filed with the registration statement, is handled along with the registration statement in routine fashion. Only if the staff recommends refusal of the request for dispensation will the matter come to the Commission for consideration. If the request is denied and the registrant fails to supply the consent, or if the consent is omitted and no request for dispensation has been made, the omission is itself a deficiency upon the basis of which a stop order proceeding may be brought; at that time, of course,

there will be a hearing on the issue.

Finally, applications for confidential treatment of contracts or other data filed under the '33 Act, the '34 Act,<sup>60</sup> or the Holding Company Act, may be granted without a hearing. The procedure prescribed by the regulations differs under the several Acts: Rule 580 of Regulation C, under the '33 Act, permits of granting without a hearing in all cases; Rule X-24-2 (b) (iii) under the Exchange Act, and Rule U-22E-1 (a) (3) under the Holding Company Act, both require that the applicant make his request for a hearing simultaneously with his initial objection to public disclosure of the matter claimed to be confidential. The terms of the latter two rules thus require hearing upon request even where there is an obvious basis for granting a request; in practice, the procedure has evolved so as to coincide with what appears to be the more desirable method prescribed by the Securities Act regulation: Hearing will not be held, even where initially requested (and to make assurance doubly sure, it is likely that the applicant will so request where he has no indication of the Commission's tentative position), if the Commission contemplates granting the application. Applications for confidential treatment are normally handled by special attorneys in the Registration Division; the General Counsel's office and the Utilities Division, respectively, who analyze the requests and reports, and report to the full Commission, which determines whether to grant, or, unless hearing has been waived, to hold a hearing prior to denial. 60. Such applications may also be denied without a hearing where the applicant consents to waive a hearing.

B.

Procedures leading to hearings

Applications leading to hearings. The

various applications, declarations, and registration statements under the three Acts lead to hearings in two types of situations: (1) In cases under the Securities Act and the Exchange Act where denial or refusal is contemplated; <sup>61</sup> and (2)(a) in all cases where applications for extension of unlisted trading privileges, withdrawal or striking from listing and registration, or termination of unlisted trading privileges have been filed under Sections 12(d) and 12(f) of the Exchange Act; and (b) with the exception of applications for confidential treatment, already noted, and of applications under Rule U-12B-1, relating to extension of credit to associate companies in specific circumstances, in all cases under the Holding Company Act.

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61. Hearings in this situation are required by the provisions of the Acts. Section 8(b) of the Securities Act requires "an opportunity for hearing" prior to the issuance of an order refusing a registration statement to become effective; Section 8(d) of the same Act imposes a similar requirement preceding the issuance of a stop order suspending the effectiveness of a registration statement. Under the Exchange Act, opportunity for hearing is required preceding the Commission's denial of an exchange's registration [Section 6(e)]; denial of

(Continued)

Because the procedures leading to hearings upon applications, declarations, and registration statements, and the hearings themselves, are in general similar to revocation cases and other cases brought by the Commission upon its own motion, discussion thereon is reserved for a later point. (infra, p. 62 ff.). It is relevant, however, to

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61. (Cont'd.) the registration of a security for trading on an exchange /Section 19(a)(2)/; denial of a broker-dealer registration /Section 15(b)/; and denial of a registration filed by an association of brokers and dealers /Section 15A(e)/. Although the Acts do not expressly so provide, it has been held that there must be an opportunity for hearing prior to the denial of an application for confidential treatment. American Sumatra Tobacco Corp. v. Securities and Exchange Commission, 93 F. (2d) 236 (app. D.C., 1937).

62. In fact, in respect of registration statements under the '33 Act, refusal proceedings, which may be brought only prior to the effective date of the registration statement, are very rarely invoked; instead stop order proceedings under Section 8(d), to suspend the effectiveness of the statement, are utilized. An 8(b) refusal order is rigidly limited by the terms of the Act. It may be brought only if the statement is "on its face" defective, the notice must be issued within 10 days after filing, and the hearing within 10 days after notice. The 8(d) stop order proceedings, on the other hand, may be brought whether the defects are patent or latent, and they may be brought "at any time" - which has been interpreted by the Commission as including the period before the effective date of the statement. Because of the narrow scope of Section 8(b) - which would otherwise seem to be analogous to denial proceedings - and because it has been held in Jones v. Securities and Exchange Commission, 298 U. S. 1 (1936), that if the proceedings are brought

(Continued)

discuss here the considerations concerning the practice of holding hearings in the cases included in the second category of the preceding paragraph, whether or not denial is tentatively contemplated by **the** Commission or its staff.

Since the bulk of the hearings on applications or declarations are devoted to those under the Holding Company Act, it is there that the problem is raised in its most acute form. Yet at least in respect of some declarations and applications, the specific terms of the Holding Company Act seem expressly to permit of granting without a hearing. Thus Section 7(b) provides that a declaration filed in respect of the issue and sale of securities "shall become effective within such reasonable period of time after the filing thereof as the Commission shall fix by rules and regulations or order, unless the Commission prior to the expiration of such period shall have issued an order to

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62. (Cont'd.) before the effective date, the registrant may under some circumstances withdraw his statement and thus escape the public disclosure and official condemnation of his attempt to defraud and mislead, 8(d) stop order proceedings - analogous to revocation - are utilized almost exclusively and are withheld until the day after the statement has become effective.

the declarant to show cause why such declaration should become effective" (emphasis supplied). Similarly, Section 10(d), relating to applications for approval of an acquisition of securities by the applicant, provides that within a reasonable time after the filing of such an application, "the Commission shall enter an order either granting, or, after notice and opportunity for hearing", denying its approval (emphasis supplied). In respect of other applications (other than applications for declaration of status or for exemptions)<sup>63</sup> under the Holding Company Act, the respective sections simply declare the several acts or transactions unlawful in contravention of the Commission's rules and regulations or orders; the rules and regulations, in turn, require applications to be made, and orders to be entered thereon (in most cases) after opportunity for hearing. Finally, it is to be noted that Section 20(c) of the Holding Company Act requires that "orders of the Commission under this title shall be issued only after opportunity for hearing."

Thus, it will be seen that several

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63. In respect of such applications, the usual provision is that the Commission shall ~~by~~ order declare, or shall by rules or regulations exempt.



problems of statutory interpretation arise under the various sections described in the preceding paragraph. The simplest provision is that of Section 7 (b) relating to declarations for the issue and sale of securities. There, no order is necessary; but, in terms similar to the provision in the Securities Act relating to registration statements, the section contemplates that the declaration may become effective by the mere passage of a reasonable time fixed by the Commission. Since the declaration may become effective without an order, therefore, Section 20 (c) requiring an opportunity for hearing prior to the issuance of an order is inapplicable. Of somewhat more difficulty is Section 10 (d), which expressly provides for granting by order an application for the acquisition of securities upon the lapse of a reasonable time; nevertheless, mention in that subsection of an opportunity for hearing is omitted in connection with granting the application, and appears only in reference to denial. Thus it seems that in respect of Section 10 (d), it is at least arguable that the specific wording therein, expressly requiring opportunity for hearing only in the case of denial, suspends the operation of the general provision of Section 20 (c).

Even if Section 10 (d), when coupled with Section 20 (c), is interpreted to require an opportunity for hearing prior to granting the application, it would seem subject to grave doubt that "opportunity for hearing" means that a hearing must always be held. The same would be true of the other orders approving applications for engaging in various transactions or for declarations and exemptions. In no case does the requirement go further than "opportunity". Accordingly, where the Commission itself is of the opinion that the application should be granted, and no person objects or requests a hearing, at least as far as the express statutory terminology is concerned, there appears to be no bar to dispensing with a hearing.

In addition, it would seem apparent that, apart from the issue of statutory interpretation, where the application or declaration presents no difficult problems and has no far-reaching consequences, dispensing with a hearing is desirable. The Holding Company Act provides for extraordinarily close supervision over utilities; myriad minor transactions are required to be licensed by the Commission. The Commission and its staff even now devote an enormous amount of time to matters under the Holding Company Act; on the

other hand, the utilities themselves are placed under a considerable burden of time and expense if they are required to go to hearing in all cases. One may well sympathize with a cry of "red-tape" from a utility which must submit even its smallest transactions - the acquisition, for example of a small block of stock - to the test of hearing where no one is opposed. In this connection, however, it should be noted that considerable relief is afforded the applicant by the provision which permits the application to be submitted without more, thus dispensing with the necessity of appearance by the applicant.<sup>64</sup>

Considerations of this nature have, indeed, led the Commission recently to modify its rule requiring hearings in all cases. On January 23, 1940, Rule U-12B-1 was amended (Holding Company Act Release No. 1893) to permit declarations in respect of a limited number of transactions involving a utility's lending, extending credit to, or indemnifying any associate company, to become effective, in the absence of affirmative action<sup>65</sup> by the Commission, upon the lapse of 20 days.

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64. See infra, p.201.

65. A parallel tendency to dispense with hearings  
(Continued)

Only in the case of denial is opportunity for hearing required as a condition precedent. Further, it is important to note, the Commission has now under consideration a proposed revision of the rules which would extend Rule U-12B-1 to other transactions under the Holding Company Act and thus dispense with hearings; Commissioner Healy, however, for reasons which in general are set out below, is opposed to the proposed revision.

It is suggested, however, that the type of transaction contemplated by Rule U-12B-1 is an exemption from a general statutory prohibition against such transactions, and that therefore the Commission has freer rein to dispense with procedural formalities otherwise necessary.<sup>66</sup> Reluctance to utilize a general procedure which would in other types of declarations and applications dispense with hearings is due to a number of considerations: It is suggested that (1) except in respect of Section 7(b), an order for approval is necessary,

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65. (cont'd) is apparent in respect of applications for fees, expenses and remunerations in connection with any reorganization, dissolution or the like under Section 11(g). Although it was formerly the practice to hold hearings on all such applications, the Commission has adopted a rule - Rule U-11F-2 (e) - dispensing with the necessity for application and hearing in proceedings under Chapter X of the Bankruptcy Act where the Commission has filed a notice of appearance in the proceeding.

66. But, in any event, it would seem that all applications under Section 12 - including declarations of dividends, solicitation of proxies, and other transactions - fall into the same category as the applications covered by Rule U-12B-1.

and no administrative order can properly issue in the absence of a hearing and a record made at the hearing; (2) findings must also be based upon a record made at a hearing; (3) the absence of a record would make judicial review impossible, especially since appeals under the Holding Company Act are not limited to parties but may be taken by "any person aggrieved"; and (4) if the Commission adopts the alternative procedure of holding a hearing only after a show cause order has been issued and denial is contemplated, the mere issuance and publication of the show cause order may result in embarrassment to the applicant, and will give rise to public speculation and surmise.

In respect of the first three points, the observations made in a previous monograph of this Committee seem relevant here:

"...all the Act requires is that the applicant be given an opportunity to be heard and that after such opportunity is afforded, the Administrator make findings supporting his order. There is nothing inconsistent with the statutory mandate in the taking of action on the basis of information which has not been incorporated in a formal record, where the applicant has not requested a hearing. The contents of the record are mere transpositions from the Administration's files, so that the hearing serves no utility other than to place the pertinent information between two. . . covers - a

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67. Federal Alcohol Administration, Monograph No. 5, pp. 34-35.

procedure which involves an unnecessary expenditure of staff time and effort.

"As to the argument that a record is necessary in order to support the Administrator's order on appeal, there are several points worth noting. In the first place, the likelihood of an appeal is extremely remote . . . /nor is there/ need to be concerned about the absence of a record /on appeal/. . . It is well established that a person who has not exhausted his administrative remedies has no standing in an appellate tribunal, a doctrine which certainly applies to an individual who has not availed himself of his opportunity to be heard. Furthermore, . . . the Act limits review on appeal to those matters to which objections were urged before the Administrator."

While, indeed, the matter is made somewhat more complex under the Holding Company Act by virtue of the broad classes of persons other than the applicant who may be interested and who are entitled to be heard (see infra, pp159-160), and by the fact that "persons aggrieved" other than parties may appeal, it would seem that a procedure could be conveniently devised which would assure full protection to interested persons. Public notice could be given of the filing of the application or declaration, and the contents thereof; <sup>68</sup> the notice should include an announcement that in the absence of objections and requests for an opportunity to be heard filed within a stated period,

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68. This of course is done under present practice.

and in the absence of the Commission's ordering a hearing on its own motion, the application will be granted, or the declaration will become effective, at a specified date thereafter. That the number of hearings ~~would~~ be considerably diminished by a device of this nature seems to be clear from the rarity with which persons appear and object at hearings on applications and declarations. And even if it be held that a person who did not request an opportunity for hearing or who did not appear is entitled to take an appeal, the appeal could be upon the basis of the files containing the pertinent information, or, if the appellant has new matter or new arguments to present, the Commission could grant an application for reconsideration (although it should be noted that a rehearing may, in many instances be an empty right since, especially where the issue and sale of securities are involved, the transaction may be completed within a few hours after administrative approval.)

It is difficult precisely to evaluate the objection that, under the procedure here proposed, the mere issuance of an order for a hearing would have a damaging effect. In contrast to stop order proceedings brought under the '33 Act, where question of false and misleading statements or

actual fraud are involved, under the Holding Company Act, approval may be withheld pending a hearing for highly technical financial reasons; or the proposed transaction may simply not be a desirable one and the Commission's wish to explore the issues further may not (and usually will not) be any reflection upon the applicant's honesty or soundness. If the danger of "stigma" is considered to be serious, the show-cause order may be accompanied by an announcement making it clear that the Commission takes no position, but because of the difficulty of the problems, or the effect which granting would have on different classes of persons, hearing to afford further exploration appears desirable. And, in any event, it is to be expected that objection to granting will not be made by the Commission's staff or outsiders in the absence of substantial grounds for doubt as to the propriety of granting without a hearing. Where such doubt exists, it does not seem entirely unfair to give an indication of its presence. Surely the stigma and damaging consequences of ordering a hearing in this class of cases are far less than the public notices in registration cases (see infra, p. 136); yet there the Commission shows little hesitancy in selecting for hearing only cases in which the existence of



deficiencies is relatively clear.

Much the same considerations apply to the practice of holding hearings upon all applications filed under Section 12 (d) and 12 (f) of the Exchange Act for the withdrawal of securities from listing, for the extension of unlisted trading privileges, and for the termination of such privileges. In this type of cases, the Commission's policies have become crystallized; the issues are rarely complex, and often approval is clear and opposition is absent. In the case of withdrawal from listing, stockholders may be immediately interested; in the case of unlisted trading privileges, the issuer, the exchange, and brokers and dealers may also be interested. Yet in a substantial number of cases, no objection is raised and no request for hearing is made. Here again, it would seem desirable to require that, where it appears to the staff that no reasons for denying the applications are present, announcement

69. In withdrawal cases, in fact, the Commission's discretion is limited: If the rules of the exchange in respect of withdrawal have been complied with, the Commission must ordinarily grant the application, subject to the imposition of conditions for the protection of stockholders. Cf. In the Matter of Allen Industries, Inc., 2 SEC 14 (1937).

should be made that the applications will be granted unless timely objection thereto, or request for a hearing, is filed.

70. As in the case of applications under the Holding Company Act, the applicant's burden of appearing and adducing evidence is considerably lightened by the provision permitting the insertion of the application into the record in absentia, if no objection has been indicated. See infra, p. 201.

Initiation of action upon the Commission's own motion. The several Acts provide that in a large number of instances the Commission may itself initiate action leading to decisive proceedings upon its own motion. Under the Securities Act, it may bring action to prevent a registration statement from becoming effective [Section 8(b)] or to prevent or suspend its effectiveness [Section 8(d)] (see supra, fn. 62). Section 12(f) of the Exchange Act permits the Commission to suspend or terminate unlisted trading privileges, but such action has thus far been taken only upon applications. Section 15 (b) of the Exchange Act provides for the Commission's proceeding to deny or revoke a broker-dealer registration; Section 15A permits the Commission to deny, suspend or revoke the registration of a national securities association or an affiliate thereof, or to suspend or expel a member or officer of such association; Section 19(a) empowers the Commission to bring proceedings (1) to suspend or withdraw the registration of a national securities exchange; (2) to deny, suspend the effective date of, suspend, or withdraw the registration of a security registered on a national securities exchange;

and (3) to suspend or expel any member or officer from a national securities exchange.<sup>71</sup> Under the Holding Company Act, the Commission may itself initiate action (1) to declare a company a holding company, a subsidiary, or an affiliate; (2) to declare an underwriter or other person ineligible to receive an underwriter's or finder's fee because of an absence of arm's length bargaining relationship; (3) to require the taking of steps to achieve integration and simplification; (4) to require a reallocation of costs among the members of a mutual service company; (5) to require a change in accounting methods to conform to the Commission's rules; and (6) to revoke any declaration or exemption previously ordered. In addition, the Commission may issue an order to show cause why a declaration should become effective under Section 7 (b), relating to the issue and sale of securities,

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71. Section 19(a)(4) of the Exchange Act empowers the Commission upon its own motion summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding ten days, or with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days. These emergency powers, for which notice and hearing are not, of course, required, have not yet been exercised by the Commission.

but since, as already described, such orders are issued in all cases, the proceeding is, in effect, initiated by the declarant rather than by the Commission in the exercise of its discretion; similarly, it may forbid a variety of other transactions, but such orders are simply disapprovals or denials of applications.

Despite its broad powers to initiate action upon its own motion, and although it is often thought of primarily as a "cease and desist" agency, it is important to note how rarely the Commission exercises such powers. It is estimated that over 90 per cent of the formal final decisions rendered by the Commission in the calendar year 1939 were brought on by applications of persons outside the Commission; less than 10 per cent were in proceedings instituted by the Commission for the prevention or  
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revocation of a license.

Procedure for initiating action. The method for initiating action upon the Commission's own motion is, in general, identical to the procedures described

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72. Less than 30 "quasi-judicial" decisions were rendered in proceedings instituted by the Commission, while more than 270 were in proceedings begun by application. Lane and Blair-Smith, The S E C and The Expeditious Settlement of Disputes (1940) 34 Ill. L. Rev. 699, 706.

above (pp. 53-55) which are utilized for the scrutiny of the various applications, registration statements, and declarations. Each of the various departmental divisions and units is responsible for initiation of action in the field over which it has jurisdiction. In addition, of course, the regional staffs may report violations or defects to the appropriate unit in Washington; while special groups may be assigned to special types of activities. Thus, for example, as already described, engineers attached to the Oil and Gas Unit travel about the country examining properties; their reports may lead to initiation of action. Similarly, a group is assigned constantly to study and follow daily stock prices and read the ticker tape, in order to detect manipulations which may lead to an action to suspend or expel a member from an exchange, or to revoke a broker-dealer registration.

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In addition to its own initial scrutiny and surveillance, the impetus for initiation of official action may - and often does - come through complaints from outsiders. The majority of the thousands of such complaints are received annually from investors;

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73. In the last fiscal year, there was a systematic surveillance of volume and price movements in respect of 3,410 issues. Fifth Annual Report (1940) 90.

other complainants include State Securities Commissions, State and Federal officials, better business bureaus, and Chambers of Commerce. The staff replies to all such complaints, and if there appears to be any substance to them, initiate both informal (i.e., inspections and interviews) and formal (i.e., obtaining of testimony under oath and pursuant to specific statutory provisions) investigations, as described below.

The several Acts vest the Commission with broad investigatory powers: Section 8(e) of the Securities Act empowers the Commission "to make an examination in any case in order to determine whether a stop order should issue under subsection (d). In making such examination the Commission or any officer or officers designated by it shall have access to and may demand the production of any books and papers of, and may administer oaths and affirmations to, and examine, the issuer, underwriter, or any other person in respect of any matter relevant to the examination..."; Section 20(a) of the same Act provides that "whenever it shall appear to the Commission, either upon complaint or otherwise, that the provisions of this title...have been or are about to be violated, it may, in its discretion, either require or permit such person to file with it a statement in writing, under oath, or otherwise, as to all facts and circumstances concerning the subject-matter which it believes to be in the public

interest to investigate, and may investigate such facts."<sup>74</sup> Section 21 (a) of the Exchange Act is in terms less restricted than Section 20(a) of the Securities Act; the Commission may conduct a formal investigation, administer oaths, and compel testimony and the production of books "in its discretion" and "as it deems necessary to determine whether any person has violated or is about to violate" the '34 Act. This Section does not require, as does Section 20 (a), that it "appear to the Commission that the Act has been or is about to be violated." Section 18 (a) of the Holding Company Act is, in general, similar to Section 21(a) of the Exchange Act. In addition, under Section 11(a) of the Holding Company Act, the Commission has the duty "to examine" the corporate structure and other elements of holding company systems to determine the extent to which they may be simplified and integrated.

Each of these powers of investigation has been extensively utilized by the Commission and for various purposes. Normally, formal investigations under these sections are used preliminary to the institution of decisive proceedings. Thus 8 (a)

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74. For a general discussion of the Commission's powers of investigation under the Securities Act, see NOTE (1938) 36 Mich. L. Rev. 786.



investigations are often held prior to the institution of stop order proceedings where there is reason to believe that latent deficiencies exist: Such investigations are currently held in about half of the cases where 8(d) proceedings are brought.

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Section 20 (a) of the '33 Act, on the other hand, is normally used in aid of judicial, rather than of further administrative, proceedings; occasionally, however, a 20 (a) proceeding is held to investigate post-effective amendments to registration statements filed under Section 8 (c).

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75. In In the Matter of Breeze Corporations, Inc., 3 SEC 709 (1938), involving a stop order proceeding under Section 8 (d), the registrant moved to dismiss on the ground that an 8 (e) investigation is a condition precedent to the institution of decisive action under 8 (d). The Commission dismissed the motion on the ground that 8 (e) was simply complementary to 8 (d), and that the Commission could, at its discretion, utilize 8 (e) when it is necessary to ascertain the facts prerequisite to the findings required for the issuance of a stop order under 8 (d). It rejected the contention that 8 (d) proceedings must be preceded by an 8 (e) formal investigation.

76. Section 8 (c) provides that post-effective amendments shall become effective upon such date as the Commission shall determine unless defective "on their face". But although post-effective amendments are initially subject to scrutiny for patent defects, if in fact they do become part of the registration statement, latent defects are subject to examination as well. Accordingly, amendments filed after the registration statement has become effective are examined by the Registration Division under the hypothesis that the amendments will become effective, and thus investigations may be necessary to explore latent defects.

Formal investigations under Section 21(a) of the Exchange Act are used somewhat less frequently prior to decisive administrative action; they are, however, ordered occasionally prior to the Commission's delisting a security under Section 19(a)(2), where there have been a number of complaints from the public and where the defects appear to be of major importance. In matters concerning broker-dealer activities under Section 15(b), 21(a) investigations are utilized in two types of situations: (1) where violation is clear, but there is doubt whether to proceed to decisive administrative action, or to seek an injunction in the courts, or to refer the case to the Department of Justice for criminal prosecution; and (2) where it is not clear whether the registration is false, or whether violations have been committed, so that further investigation is necessary.

Formal investigatory hearings under Section 18(a) of the Holding Company Act are sometimes held prior to decisive proceedings in applications for exemption as a subsidiary, or to cases under Sections 2(a)(7) and 2(a)(8) involving the determination whether a company exercises, or is subject to, such control as to be a holding company or subsidiary, as the case may be. In both

these types of cases, the factual situations may be complex and questions of intangibles may enter; accordingly, formal investigations are found to be useful. In addition, of course, the examination of holding company systems under Section 11(a) has been proceeding for some time; it is simply an intensive study of the several systems in preparation for the integration and simplification proceedings which are just now being instituted.

Initial responsibility for initiating formal investigations rests in the particular division or unit in Washington in whose jurisdiction the subject-matter lies. <sup>77</sup> The characteristic of centralization in the Commission which has already been noted obtains in respect of authorization to hold formal investigations: The recommendations of

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77. In the case of the Over-the-Counter unit of the Trading and Exchange Division, recommendations to proceed to formal investigations are prepared jointly by that unit and the Enforcement Section of the General Counsel's office. This is partly because the Over-the-Counter Unit is somewhat less autonomous than the Registration Division, partly because where revocation of a broker-dealer registration is involved, there is likely to be wilful violation of the '33 or '34 Acts, which might be subject to court proceedings brought under the direction of the Enforcement Section. Occasionally, the '34 registration unit may not participate in the recommendation as to whether to hold formal investigations; the recommendation may proceed directly from the field office to the Enforcement Section and thence to the Commission.

the staff are passed upon by the entire Commission. It is stated that requests for authorization are customarily granted by the Commission, but it is not uncommon for the Commissioners to narrow the scope beyond the staff's recommendations.

The Commission's order authorizing the investigation constitutes the notice of such investigation; ordinarily, the order in investigations under Section 21(a) of the Exchange Act simply recites that the investigation is being held to determine whether specified sections of the Act are, or are about to be violated. Occasionally, however, where delisting is involved the specific items suspected of being deficient will be set out in the notice. In 8(e) proceedings, on the other hand, the defects are usually set out with the same particularity [e.g., In the matter of Unity Gold Corp., 3 SEC 618 (1938)] which marks the notice of decisive 8(d) proceedings, and, it is said, the order for an 8(e) investigation would be required to be amended before deficiencies not set out in the order could be explored. In general, it may be noted that the tendency in respect of the notice of such investigations has been increasingly to depart from a mere recital of the existence of a reason to believe that a specified section of the statute is, or is about to be, violated and to include some indication of the bases of such belief or some reference to the particular conduct to be investigated. Especially, in view of the fact that a subpoena power accompanies these orders, this tendency seems desirable.

Where formal investigations are utilized as preliminaries to decisive proceedings, the person being investigated is

normally not sent a notice, which, in any event, is not public. The order for investigation, which includes the notice, is, however, exhibited to any person examined in the course of such investigation who so requests; since ordinarily the investigation will include the examination of the person suspected of violation, he will, thus, have actual notice of the investigation. Since a person may, on the other hand, be wholly unaware of the fact that he is being investigated until his friends who are interviewed so inform him, and since this may sometimes give rise to antagonism and a feeling that the Commission is besmirching him behind his back, no reason is apparent why, simply as a matter of good will, the Commission should not in ordinary cases send a copy of its order for investigation to the person under investigation.

As set out more fully below, the formal investigation may vary in purpose: (1) They may be investigations preliminary to the institution of decisive proceedings; (2) they may be public hearings to probe matters of general interest; (3) they may be auxillary to the decisive proceedings to examine hostile witnesses; and (4) they may be broad policy making studies. In addition the formal investigation may either consist simply of roving interviews of persons and examination of books, or it may consist of an investigatory hearing. The order for investigation designates one or more "presiding officers" to take testimony and administer oaths, but as a rule, the presiding officer is not expected to conduct himself as a trial

from a mere recital of the existence of a reason to believe that a specified section of the statute is, or is about to be, violated and to include some indication of the bases of such belief or some reference to the particular conduct to be investigated. Especially, in view of the fact that a subpoena power accompanies these orders, this tendency seems desirable.

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The nature of the formal investigation varies. It may either consist simply of roving interviews of persons and examination of books, or it may consist of an investigatory hearing. The order for investigation designates one or more "presiding officers" to take testimony and administer oaths, but as a rule, the presiding officer is not expected to conduct himself as a trial

examiner but rather as an investigating attorney. The presiding officer is not, accordingly, usually selected from the regular group of trial examiners, but is an attorney attached to the Enforcement Section of the General Counsel's office or to the particular division involved; often, indeed, he is the same attorney who will later act as Commission counsel in the decisive proceedings.

The Commission's Rules of Practice expressly provide that all such rules (governing notice, amendments, objections to evidence, briefs, and the like) are inapplicable to formal investigatory hearings in the absence of express provision to the contrary in the order and with the exception of Rule II, which relates to appearance and practice by representatives before the Commission. The testimony given in such investigations is recorded (usually by the available staff stenographic force, rather than by a hearing reporter). In the usual case, witnesses are granted the right to be accompanied by counsel, but the latter's role is limited simply to advising the witnesses in respect of their right against self-incrimination without claiming the benefits of the immunity clause of the pertinent statute (a right of which the presiding officer is, in any event, instructed to apprise the

witnesses) and to making objections to questions which assertedly exceed the scope of the order of investigation.

While the formal investigations are not regarded as adversary proceedings and there are no "parties" or "issues",<sup>78</sup> the Commission may occasionally permit the prospective respondents full rights of counsel, as well as the right to adduce pertinent evidence and cross-examine witnesses. This course is one commonly followed where it is stipulated at the outset of the hearing that the testimony and evidence may be utilized at the decisive proceeding, subject to the right to introduce further evidence, and to explain, control, or rebut the testimony so offered.<sup>79</sup> In the case of 8 (c) proceedings, it is not uncommon for the parties to stipulate the 8 (c) record into the record of the 8 (d) hearing and, indeed, sometimes this may constitute the entire 8 (d) record. In general, however, in the absence of stipulation the record of investigation does not become part of the

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78. Cf. In the Matter of Harold T. White, et al., 1 SEC 574 (1936)

79. This does not, however, transform the investigation into a de facto hearing. Id.



decisive proceeding's record, and, indeed, information or documents obtained in the course of such investigations are deemed confidential. Staff members are under injunction not to divulge such material in preparing testimony subsequently given in the decisive proceeding. Transcripts of their own testimony are ordinarily furnished the witnesses as a matter of grace rather than of right, but a full transcript is not given to the person under investigation; in any event, even if witnesses may not retain transcripts of their testimony, they may examine them for correction and confirmation.

A different utilization of formal investigations is occasionally made: Their purpose may be less to uncover material leading to decisive proceedings than to invoke the sanction of publicity and fully to explore important events of public interest. As already noted (supra, p. 20) such public investigations, in contrast to the usual private ones, have been utilized notably in three widely-known cases: McKesson & Robbins, Inc., Richard Whitney, and Union Electric. In investigations of this type, the procedures assume a somewhat more adversary characteristic; although no decisive order can issue as a result of such investigations, they are in fact, if not in theory, proceedings against the persons to be exposed, and extensive and complete public reports are made on the basis of the investigations.

Trial examiners from the regular staff may be appointed to preside; although the usual rules of practice are not made applicable, the right to cross-examine and adduce evidence is given to those investigated. Full public notice, served upon the persons investigated, is given. In the most recent investigation of this nature, a novel form of notice was used. It stated that the Commission's public files disclosed certain facts, that "the Commission obtained information from various sources as to the existence" of certain conditions and practices, that named staff members of the Commission "have reported to the Commission evidence obtained ... tending to show that ... conditions and practices enumerated below may have existed", that therefore "it appears to the Commission to be necessary and appropriate in the public interest to determine whether" substantial sums have been disbursed to officers and other employees other than those designated and improperly reflected in the books, whether substantial contributions were made for political purposes, and whether the improper practices specified occurred. It is to be noted that this notice seems deliberately designed to avoid any statement of belief on the part of the Commission in respect of the truth of the charges; it simply recited the existence of

information supporting the charges of improper practices. Neither the evidence nor the precise transactions (other than their nature) were stated with any degree of particularity. While, thus, the notice seems sufficient as a sound and safe basis for the issuance of subpoenas, it is questionable whether it might not be desirable, because of the important nature of the proceedings, the consequences to the persons investigated and the fact that they are likely to be translated into de facto adversary proceedings, to specify the transactions, by date or actors, alleged to have occurred; it must be conceded, however, that since these are no more than investigations, the Commission should not unduly limit itself, and there is sufficient particularity from a legal point of view. In addition, the Union Electric case was a unique one involving a number of transactions with persons whose identity it would have been harmful to disclose in the absence of hearings.

Still a third kind of formal investigation may occasionally be used under Section 20(a) of the Securities Act and Section 21(b) of the Exchange Act: They may be investigations not strictly preliminary to, but rather auxiliary to and concurrent with, the decisive proceeding. Such investigations are used in part for the purpose of securing evidence to be used in the decisive proceeding, but chiefly as a method whereby the Commission may examine hostile

witnesses apart from the main hearing. Respondents apparently have no correlative right to

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80. An interesting controversy arose in connection with the use of 21 (a) proceedings ancillary to the decisive proceedings in In the Matter of Gerald M. Loeb and Gordon B. Crary, 3-SEC 524 (1938). The Commission had, on March 13, 1937, issued an order for investigation, pursuant to Sections 21 (b) and 19 (b) of the Exchange Act, to determine whether any one of 41 named persons had violated certain statutory prohibitions. As a result of this investigation, on December 30, 1937, the Commission instituted decisive proceedings against Loeb and Crary to expel or suspend them from certain stock exchanges. After the institution of decisive proceedings, however, the investigation continued and the presiding officer thereof issued subpoenas for a number of persons, directing them to testify in respect of trading in the same stocks in violation of the same statutory provisions concerning which decisive proceedings had been brought against Loeb and Crary. The persons subpoenaed refused to appear, and Loeb and Crary moved to quash the subpoenas and to modify the order for the 21 (a) investigation "so as to provide that the officers designated in said order shall not, pursuant thereto, subpoena witnesses or require the production of books ... for the purpose of preparation by the Commission, its counsel or representatives," for the decisive proceedings against them. Their argument to quash was based in part upon the contention that the subpoenas were invalid since the commencement of the decisive proceedings had pro tanto nullified the powers of the officers to carry on the investigation. The respondents further argued that the Commission can issue subpoenas only (1) if it is investigating to determine whether decisive proceedings shall be brought, or (2) in connection with testimony to be adduced at the decisive proceeding. The Commission denied the motion to quash and held that the Exchange Act does not limit formal investigations to the issue whether decisive proceedings should be brought. It stated that even if its powers were thus limited, it is settled that "if an investigation is undertaken (continued)

examine Commission witnesses and discover adverse  
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evidence; the Commission's powers, thus, in this  
respect are both large and useful to the successful  
conduct of its own case. But it is stated by the  
Commission that it is not an unfair nor one-sided  
right, since in this type of cases questions of  
evidence peculiarly in the knowledge of the respon-  
dent are ordinarily involved and, accordingly, no

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80. (Cont'd.) for a purpose admittedly within  
the investigating body's power, the fact that the  
investigation may have likewise been prompted by  
an incidental or even a dominant purpose which  
falls without that body's authority will not defeat  
the investigation." In the instant case, the  
Commission held, one of the purposes of the con-  
tinuing investigation was to determine whether new  
charges should be brought against the respondents  
and others. Thus the subpoenas were properly  
issued since there was some valid basis for the  
continuance of the investigation. But in the  
"exercise of discretion" the Committee directed  
the presiding officers not to utilize their in-  
vestigatory powers for the purpose of preparing  
for the current decisive proceeding; but "Nothing  
in this opinion is intended to cast any doubt upon  
the propriety of utilizing any information thus  
obtained." The only reasons assigned by the  
Commission for thus exercising its discretion in  
restricting the powers were that (1) its investi-  
gation had already continued for two years; and  
(2) the respondents' counsel had expedited the  
hearing by stipulating to the production of impor-  
tant pre-hearing data. Therefore, according to  
the Commission's opinion, the restrictions imposed  
would not "unduly hamper" counsel for the Commission  
in the preparation of their case.

81. A motion by respondents for an examination of  
Commission witnesses before trial was denied in  
In the Matter of Gerald M. Loeb and Gordon B. Crary,  
3 SEC 324 (1938).

hardship is imposed upon respondents since they are already aware of all the facts, while the Commission, on the other hand, is the stranger who needs assistance.

Still a fourth type of investigation - which may be a formal one under the pertinent sections of the Act or may be informal - utilized by the Commission is the investigation to inform itself of general problems and policies. Such investigations do not precede or lead to any particular decisive proceeding; rather their purpose is study and research for the purpose of such general background as will be useful in determining groups of subsequent cases. Investigations of this nature have been employed by the Utilities Division, whose attorneys and other staff members to whom particular holding company systems have been assigned have made field examinations of such systems, inspected them, and talked generally to the system's officials and others in order to gain the practical knowledge which is necessary to make subsequent determinations. Similarly, "background" investigations may be employed to assist in the formulation of general policy in respect of special problems and types of cases. Such an investigation was utilized as a prelude to the Commission's dis-

position of applications for confidential treatment shortly after the Exchange Act had been passed. Hundreds of such applications were filed, requesting suppression of data concerning salaries paid to management and gross sales and cost of goods sold. Unable abstractly to determine whether disclosure of such data would be harmful and would result in extensive price-cutting, as claimed by the applicants, a special investigation, conducted by three attorneys, assisted by accountants and analysts, was initiated by the Commission. This group travelled about the country interviewing experts and business men, and examining books and sales methods. As a result of this research, it was found that cost figures were, in fact, rarely a secret, and that they had little to do with the forces determining buying policies or price competition. Although until then the Commission had been rather liberal about granting applications for confidential treatment, after the study "decisional policy naturally, and rightly, shifted."<sup>82</sup>

Other pre-hearing methods. In addition to its investigations to determine whether to hold decisive proceedings, and to shape the case for such

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82. Landis, op. cit. supra, note 8, pp. 41-44.

proceedings, the Commission makes extensive use of the pre-hearing conference technique, especially in reference to cases issuing under the Holding Company Act.<sup>83</sup> Almost invariably after a holding company or subsidiary files an application or declaration, conferences are held with the Utilities Division staff and even with the Commission itself. These conferences have been described by the present chairman of the Commission:<sup>84</sup>

"...we and our staff, before a hearing, try to assist the companies and their lawyers, accountants and engineers, so that the facts presented will lead to decisions which are both in accordance with the statute and business-like. In those preliminary discussions, we employ the informal method of the round-table conference... We and those with whom we confer think out loud and in the vernacular; we and they put our feet on the table and unbutton our vests."

As a result of these informal conferences and negotiations, the issues are framed and the areas of disagreement are pricked out and narrowed. Normally,

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83. The technique of disposing of cases involving registration statements through deficiency letters and other informal negotiations has been described above, pp. 56-60. Conferences under the Holding Company Act, on the other hand, cannot now dispose of the case (unless they result in the withdrawal of the application) since hearing is necessary in any event.

84. Address by Jerome Frank before the Association of the Bar of the City of New York, May 5, 1940.



by means of these conferences, no substantial factual issues remain for the hearing, and, indeed, not seldom the only remaining purpose of the hearing is to make a record which will embody and support the fruits of the conferences. It seems clear that the Commission has been highly successful in simplifying and diminishing the usual formal litigious process through its conference technique.

More formal methods for disposing of cases adversely to the applicant or other person involved are occasionally utilized in cases arising under the '33 and '34 Acts. Decisive proceedings leading to the refusal of a registration of a security for trading on an exchange are ordinarily avoided through negotiations between the Commission's staff and the certifying exchange; where refusal is contemplated, the exchange will usually withdraw its certification and the need for formal proceedings is ended. Similarly, the deficiency letter technique, already described, may lead to the registrant's withdrawal of his statement - a technique which has been formalized and extended by Rule X - 12D3 - 8 (c), in respect of the registration of an unissued security for "when issued" trading, which provides that

"If 40 days have elapsed since the sending of any notice of deficiency, other than one which has been withdrawn, and neither the issuer nor the exchange has made a written request to the Commission for a hearing to determine whether such registration shall become effective, such application shall be deemed withdrawn unless the Commission extends the time within which such request may be made." 85

Procedure for and effect of the issuance of a show cause order; summary suspensions. Primary responsibility for the initiation of decisive action is vested in the division or unit in whose jurisdiction the subject-matter lies; memoranda and recommendations are prepared by the appropriate staff units. An additional step is ordinarily involved where there has been a formal investigation. The presiding officer in such investigations normally prepares a report which analyzes the evidence prepared and includes recommendations in respect of the action he believes should be taken;

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85. In ordinary registration cases, mere failure to respond to deficiency letters or to request a hearing thereon does not permit of the adverse disposition of the case: A show cause order must, nevertheless, issue and hearing must be held. See infra, pp.151-153. The Commission has adopted the more flexible technique in respect of "when issued" securities since the granting of a special privilege is involved and therefore it feels somewhat more free to dispense with formalities.

there are no findings of fact as such. The report is an internal one; it is not submitted to the prospective respondents for exceptions or oral argument and, of course, the report is purely advisory.

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The memorandum, report, and recommendation are then submitted to the Commission, except in the case of proceedings involving the denial or revocation of a broker-dealer registration, where the matter flows from the over-the-counter unit to the General Counsel's office and thence to the Commission. In no case may the staff institute decisive proceedings; Commission authorization is a condition precedent. Conversely, at least where there has been an 8 (c) investigation in respect of registration statements, Commission approval of a recommendation not to go to decisive 8 (d) hearings is also necessary. The Commission's consideration of the question whether to issue a show cause order is said to be by no means perfunctory; although the Commission rarely rejects the staff's recommendations, not infrequently they limit the scope of

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86. In one case where the formal investigation was permitted to assume adversary characteristics because a stipulation that the evidence adduced therein was to be used in the subsequent decisive proceeding, the Commission's counsel "as a matter of courtesy" submitted the report to the prospective

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the order more narrowly than is recommended.

Although it has been suggested in other monographs prepared by this Committee's staff that the heads of the agency might properly delegate in large measure the function of determining whether to issue complaints or order decisive hearings, and that it would be desirable for them to reserve themselves for the task of ultimate adjudication,<sup>87</sup> different consideration seem to justify a contrary conclusion in the case of the Securities and Exchange Commission. First, as already noted (pp. 84-85), issuance of show cause orders in the nature of complaints are comparatively rare, and, accordingly, there is no serious drain upon the commissioners' time or energies. Second, and even more important, the issuance of the complaint is, so far as the respondents are concerned, often of

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86. (Cont'd.) respondents. The report recommended that no decisive proceedings be brought, but the Commission rejected the recommendation. The respondents moved to dismiss the decisive proceedings on the ground that the Commission had ex parte "disregarded" the report. The motion was denied on the ground that the report was a purely internal advisory memorandum and its submission to respondents did not change its character. In the Matter of Harold T. White, 1 SEC 574 (1936)

87. Federal Trade Commission, Monograph No. 6, pp. 18-21; National Labor Relations Board, Monograph No. 18, pp. 18-23.

as much consequence as - if not more than - the ultimate decision. As described in the subsequent paragraph, the mere institution of proceedings may have certain legal consequences restricting the respondent; in addition, the issuance of a complaint has vital practical consequences adverse to the respondent. In the case of registration statements in respect of securities, a show cause order reciting alleged defects often amounting to fraud, virtually suspends their marketability; further, time is of the essence, and by virtue of the institution of formal proceedings, time is lost. As stated by the Commission's General Counsel in a recent speech --

"Whether the SEC on final consideration will actually decide to enter a stop order is interesting, but not very important; for only a rare investor would purchase securities threatened with the administrative bar. When the SEC actually delists the security, the news is important; but the market drops when the order for hearing is announced."

The same - although perhaps to a less extent - is true where registration of brokers and dealers, or expulsion from an exchange, is involved. Business is difficult when attempted to be operated under the cloud of a show cause order of this nature. Under such circumstances, where as a practical matter the insti-

tution of decisive proceedings may in fact be that step in the process which has the greatest practical significance, it seems desirable for the Commission itself to retain control over the step.

As already stated, the institution of decisive proceedings may be accompanied by certain legal consequences as well. Thus, initiation, prior to the effective date of a registration statement, of a stop order proceeding under Section 8 (d) of the Securities Act postpones the effectiveness of the statement and amendments filed thereto until final determination; the operation of the automatic 20-day period is thereby suspended.<sup>88</sup> In respect of oil and gas offering sheets, Rule 340 of Regulation B empowers the Commission to enter an order temporarily suspending the effectiveness of the filing of each offering sheet pending final hearing if, at any time within seven days of the receipt of filing, the Commission has reasonable grounds to believe that the offering sheet is defective. Such suspension orders, which are usually issued

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88. Jones v. Securities and Exchange Commission, 298 U.S. 1 (1936), In the Matter of Peterson Engine Co., Inc., 2 SEC 873 (1937). Institution of 8 (d) proceedings after the registration statement has become effective does not suspend the effectiveness of the statement; in fact, however, the respondent sometimes agrees to sell no securities pending final determination.

automatically when decisive proceedings are instituted, expire if there is a request for hearing and the Commission has not set a hearing within 30 days of such request; in any event, the temporary suspension order may not remain in effect more than 60 days after the decisive hearing is finally closed. Rule 380 of Regulation B-T gives the Commission similar powers in respect of an oil royalty trust prospectus; in that case, however, ten days after filing are allowed in which the order may be issued.

Section 15(b) of the Exchange Act empowers the Commission summarily to postpone the effective date of a broker-dealer registration pending hearing on denial; again, the 15-day postponement is virtually automatic when decisive proceedings are instituted. Section 15(b) further provides that in both denial and revocation cases, the Commission may indefinitely postpone or suspend the registration of brokers or dealers pending final determination; but the machinery is unwieldy since notice and hearing are required prior to such postponement or suspension and the final determination consumes only a little more time than the determination whether to

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postpone or suspend. Accordingly, where there is need for expedition, the Commission is more likely to resort to the courts for a preliminary injunction than to resort to administrative proceedings indefinitely to postpone or suspend.

Still other provisions are made by the Exchange Act for summary action pending final determination; Rule X - 12 A - 4 (c) permits the Commission to suspend the exemption of warrants pending decision as to whether such exemption shall be revoked; and Rule X - 12 D 3 - 8 (b) and X - 12 D 3 - 9 empower the Commission to suspend the registration of an unissued security for "when issued" trading, "for any period of time" pending final determination whether the registration shall be revoked. Finally, a similar power to suspend a prior order approving an investment program of a registered holding company or subsidiary is vested in the Commission by Rule U - 9 C - 4 (g) under the Holding Company Act pending final decision on

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89. In fact, when postponement or suspension are contemplated, hearing thereon is held simultaneously with the hearing on denial or revocation; the issues, however, are somewhat different.



revocation of such order.

90. Under the Holding Company Act there is provision for the converse of summary temporary suspensions. Applications filed with the Commission to declare that the applicant is not an electric or gas utility, or not a subsidiary or holding company, or applications or exemptions by statute entitle the applicant to the declaration or exemption desired pending final determination "if filed in good faith." Similarly, under certain circumstances, when an application is filed by a service company for permission to perform services for holding companies or subsidiaries, the applicant may perform such services pending final determination. Rule U - 13 - 3 (b).

The procedure for determining whether an application is filed in "good faith" has not been established; it is said that it requires a full knowledge of the facts and as much time to determine that issue as it would take to make the final determination. cf. In the Matter of the Application of International Paper and Power, 2 S E C 274 (1937). Accordingly, it is assumed that applications are filed in good faith, but no findings or announcements to that effect are made. Nevertheless, the situation is an awkward one; at least theoretically the applicant acts at his peril in failing to observe the obligations of the Act, since he does not know whether the Commission may proceed against him on the ground that the application was not filed in good faith. For the confusion which may be created, see the statement of the International Paper case, *supra* note 37. But it is said that the problem is not actually a serious one and that the only practical solution is to have the issue of "good faith" tested in a proceeding in court against the applicant for violation of the Act.

Orders to show cause and other notices of

hearing: (1) Content. In each case where the several Acts require hearings, notice is also necessary under the terms of the applicable section.

Thus the Acts require notices prior to (1) refusal to permit a registration statement under the '33 Act to become effective,<sup>91</sup> or to suspension of the effectiveness thereof; (2) denial, suspension or revocation of a national securities association or national securities exchange registration; (3) suspension or withdrawal of the registration of a security for trading on an exchange; (4) suspension or expulsion of a member or officer from an exchange; (5) extension or termination of unlisted trading privileges; (6) denial or revocation of a broker-dealer registration; (7) revocation or modification of an exemption order previously issued under the Holding Company Act; and (8) issuance of any order<sup>92</sup> under the Holding Company Act. In addition, Rule

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91. Notice of a refusal proceeding must be issued within 10 days of filing.

92. Section 7(b) of the Holding Company Act provides that declarations with respect to the issue and sale of securities shall become effective within a reasonable period after filing in the absence of an order to show cause to the contrary. As already described, the Commission's policy has been to hold hearings in any event. In one case such a  
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III (a) of the Rules of Practice provides that "Whenever a hearing is ordered by the Commission in any proceeding, notice of such hearing shall be given by the Secretary or other duly designated officer of the Commission."

In all cases, the notice shall state the time, place and subject matters to be heard; further, in proceedings instituted by the Commission, the notice must be accompanied by "a short and simple statement of the matters to be considered and determined" (Rules of Practice III a).

The degree of completeness and particularity marking the notice or order to show cause varies according to the type of case involved.

Rule III (b) of the Rules of Practice provides:

"Whenever a hearing is ordered by the Commission in any proceeding pursuant to Section 8 of the Securities Act of 1933, as amended, . . . notice . . . shall include a statement of the items

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92. (Cont'd) hearing was begun by the issuance of an order, but not an order to show cause; accordingly, a second hearing, this time following a show cause order, was required to be held unless the company waived such a second hearing and permitted a denial on the basis of the first hearing. Of. In the Matter of Declaration of Northern States Power Co., 2 SEC 825 (1937). This cumbersome arrangement has since been cured by the issuance of Rule U-6B7-1(b), which provides that "Every order for hearing on a declaration shall include an order to show cause why such declaration shall become effective." Thus a denial can now issue on the basis of a single hearing.

in the registration statement by number or name which appear to be defective/  
... The ... notice shall be accompanied by a short and simple statement of the matters and items specified to be considered and determined."

Pursuant to this provision, the initial telegraphic notice simply lists the items alleged to be deficient; the "statement of matters to be considered" is in brief form, and sets out, for example, that under a specified item, the "adequacy and accuracy," or the "misleading effect" of an identified entry, or that "omission of information," are questioned. There are no affirmative allegations that the statements are false, nor does the notice allege what are believed or claimed to be the true facts. Since the gist of the proceeding is to determine whether the registration statement is inaccurate, and since the respondent is ordinarily in the best position to know what is the truth, it is submitted that a notice of this kind is ample to frame the issues and apprise the respondent thereof.

The show cause order in cases involving the revocation of a broker-dealer registration, on the other hand, may include allegations of considerably more detail and specificity. Thus, a recent notice in such a case alleged that respondent made specified false statements in the appli-

cation for registration "whereas in truth and in fact" a different situation affirmatively and specifically alleged existed. Notice in proceedings brought by the Commission to delist a security resembles those in broker-dealer registration cases: A typical allegation is that "Item 10, subdivision (i) calls for the name of the principal underwriter . . . . The Commission has reasonable grounds to believe that certain persons, who are not named in reply to this item, were underwriters." <sup>93</sup>

Controversy concerning the specificity of the Commission's notices in cases begun on its own motion has largely centered upon proceedings involving violations of the prohibition against

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93. In one case, a court criticized the notice of a delisting hearing as being too specific and as pleading evidence. This was a proceeding in which the Commission relied upon and alleged certain information gained from the confidential files of the Comptroller of the Currency. The court stated that "Lacking specific congressional authorization, we think . . . . pre-trial publication of evidence - labeled as believed to be true - ought . . . to be avoided . . . ." Bank of America National Trust & Savings Ass'n. v. SEC, 105 F. (2d) 100 (App. D.C., 1939). For a critical comment on this decision, see (1939) 7 U. of Chi. L. Rev. 150. Probably in response to this decision, however, there has been a tendency for the Commission's notices to substitute a statement that "members of its staff have informed it that. . ." for the former phrase that "the Commission has reason to believe that . . . ." Quare: Does the Bank of America case do more than condemn the presentation of the allegations in the form of a "belief" of the Commission, so that its criticism could be disposed of by refraining the notice as a statement of whether certain specified things are or are not true?

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manipulation under Section 9 of the Exchange Act. Ordinarily, the notice alleges only that during a certain period (usually of considerable length) acts were committed - set out in the terms of the statute (e.g., "directly and indirectly, used the mails, divers means and instrumentalities of interstate commerce" and "effected alone and with one or more persons a series of transactions . . ."). The instrumentalities utilized, the precise dates of the transactions, the persons involved, the prices at which the stock (which itself is, however, identified) were bought and sold are not specified.<sup>95</sup>

In defending the generality of the allegations, the Commission stated<sup>96</sup> that notice "does not require that all the particular acts, which together constitute the

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94. Cases involving the sufficiency of notice in this type of proceeding include In the Matter of Michael J. Meehan, 1 SEC 238 (1935); In the Matter of Charles C. Wright, 1 SEC 482 (1936); In the Matter of Gerald M. Loeb, et al., 3 SEC 358 (1938); and In the Matter of White-Weld, 3 SEC 466 (1938).

95. But in a show cause order involving the revocation of a broker's registration, the precise transaction - its date, nature, place, and prices - was alleged. In the Matter of G. L. Olstrom & Co., SEA Release No. 1964. But the manipulation there comprised a single transaction by a single person; there was no element of conspiracy or complex course of conduct as marked the cases cited in the preceding footnote.

96. In the Matter of Michael J. Meehan, 1 SEC 238 (1935).

offense, shall be detailed and itemized. Such particulars are 'matters of evidence and not of averment' . . . There is no duty on the part of the Government to go into such detail . . . as to include therein the nature of the oral testimony which the Government intends to produce."

In addition, the Commission's opinion indicated its view that the "inherent flexibility" of administrative procedure "makes for less strictness in insistence upon technicalities" especially because of the readiness with which hearings can be adjourned and witnesses recalled in the event of surprise. In a subsequent case, the Commission assigned as further basis for the generality of the allegations the fact that "It is in the nature of these transactions that they should be peculiarly within the knowledge of the respondents, and may be committed under circumstances which render impossible a specific description."<sup>97</sup> In addition, it has been suggested that

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97. In the Matter of Charles C. Wright, 1 SEC 482, 484 (1936). But it has been argued that an examination of the records in these cases does not support the conclusion that the transactions constituting a violation of the prohibition against manipulation should be "peculiarly within the knowledge of the respondents." In the Meehan case, it is urged, "the Commission found the respondent responsible for purchases made by customers of branch offices of other firms because the respondent, or somebody related to him, had advised customers' men of these branch offices that the security in question was 'a good speculation' or was 'a good buy'. To sup-

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manipulation cases "which are essentially conspiracy cases), since they involve intent, lend themselves readily to the manufacture of evidence, and that, accordingly, if the allegations set out each specific transaction, the respondent would have little difficulty in finding justification for each as a bona fide purchase or sale.

Evaluation of these considerations is difficult in the absence of more concrete experience. It is true that the respondents will in the course of the hearing and through the trial examiner's report be apprised of the nature of the case against them with considerable precision; further, the Commission has ample precedent in criminal indictments involving conspiracy. In addition, the granting of requests for bills of particulars has alleviated the burden

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97. (cont'd) port this conclusion, the words of the statute 'to effect either alone or with someone or more other persons any series of transactions' must be construed to include transactions which will not be peculiarly within the knowledge of the respondent. The theory of the Meehan opinion seems in direct conflict with the analogy on which the Commission relied to justify its refusal of the detailed statement . . . ." Redmond, op. cit. supra, note 19, pp. 637-638. Nor does Mr. Redmond agree that the availability of adjournments cures the difficulties, since proper preparation of the case before hearing and "effective cross-examination must be based upon some knowledge of the facts." Ibid.



upon respondents to some extent, although the bills themselves have been somewhat general in nature, are stated by the Commission not to limit its offering of proof on other matters, and have been criticized as being unsatisfactory in their failure to isolate or describe the transactions involved.<sup>98</sup> Nevertheless, the generality of the allegations undoubtedly places a severe burden upon the respondents if, as it must be assumed, he is innocent. In one case, during the period alleged in the order, the respondents engaged in some 300 transactions through 75 different brokers. Since the respondent must be ready to meet whatever evidence is presented, and since rebuttal involves the collection of a multitude of witness and docu-

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98. Ibid. Cf. cases cited supra, note 94. It is to be noted that much the same problem exists in respect of cases involving the issue of control--an issue which becomes important in declarations of companies as holding companies or subsidiaries under Sections 2 (a) (7) and 2 (a) (8) of the Holding Company Act, and in registrations of brokers and dealers where the Commission alleges the existence of silent partners not named in the application. In these cases, the allegations of control simply follow the statutory terms or state the ultimate fact of control: Precise relationships or the specific elements of control are omitted. Cf. In the Matter of Walston & Co., 4 SEC (1939) (denial of a request for a bill of particulars). It is said that control involves intangible relationships and a multitude of small facts, so that specific allegations would be impracticable.

ments, the difficulties placed upon the respondents would seem to be considerable. Further, more specific allegations would probably diminish the present tendency of the records in manipulation cases to be of such immense length, although, of course, since in their nature these cases involve a long series of transactions and a conspiracy to defraud, length and loose ends are inevitable. On the whole, however, it would seem desirable for the Commission to be somewhat less insistent upon its legal right to give only the minimum and, if not through the show cause order, then through a greater liberality in respect of bills of particulars (which have been denied in several such cases), to frame the issues with greater particularity.

A somewhat different problem arises from the nature of the notices of hearings held upon applications filed under the Holding Company Act. As described above, hearing is held in all such cases; accordingly, the notice does not include allegations by the Commission's staff or any indication of what the proposed disposition of the application will be. Instead, the notice is confined simply to an announcement of the filing of the application, the action sought by the applicant

to be approved, and the time and place of hearing. The Commission might ultimately deny such application, or it might impose important conditions upon its approval - conditions such as a requirement that the applicant may issue and sell stock provided it freezes certain funds to build up a surplus. Such a condition might involve a requirement that the applicant pay no dividends on its common stock for a stated period; or the application itself, if granted, may alter rights and priorities. In either case, it will be noted, security holders will be immediately affected. Thus the notice must be tested from the point of view of its adequately apprising not only the applicant, but also the persons who might be affected by the approval of the application or declaration or by the imposition of conditions.

In respect of the first question - adequacy of notice to the applicant or declarant - there is no great difficulty. First, as stated by the Commission's General Counsel, "Since the proceeding is instituted by the declarant, he is, of course, fully aware of the questions to be considered." Second, although in form the notice gives the applicant or declarant no indication of the Commission's attitude, or of the particular

fields which it may wish to explore, in fact, by virtue of the conferences which precede the hearing and continue during its course, the applicant or declarant has actual notice of the issues and can, accordingly, prepare himself. Indeed, it is common for the Utilities Division staff informally to communicate to the applicant that the latter should be prepared to adduce evidence in respect of specified points and should produce named witnesses.<sup>99</sup> If, on the other hand, the position of the staff has not crystallized prior to the hearing, the applicant will be informally notified during or even after the hearing of any new position taken. Finally, if the Commission itself, when the case reaches it for ultimate determination, should decide to impose new conditions not previously indicated to the applicant, the latter will be immediately notified, conferences will be held, and opportunity will be afforded the applicant to reopen the hearing or obtain argument thereon. It seems clear, therefore, that despite the bareness

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99. In one case involving an application for approval of a mutual service company, the staff sent a letter outlining "six points of doubt." Cf. In the Matter of The Kansas Electric Power Co., 1 SEC 891, 896 (1936), where the declarant was notified that witnesses who could testify on the question of the underwriter's spread should be brought to the hearing.

of the notice, the applicant will at some point be fully apprised of all pertinent matters.

Whether stockholders and other persons who may be affected are sufficiently apprised by the order for hearing is a more difficult and complex problem. A typical notice in respect of applications for approval of the acquisition of securities under Section 10 (a) of the Holding Company Act sets out only that "The matter concerned herewith is in regard to the issue and sale by X of /specified/ bonds in the amount of . . . . It is proposed that the sale of securities be as follows . . . . B seeks approval of the acquisition of /specified/ stock of /a named company/ at /a specified price/." Normally, an alert stockholder or other interested person will know from such a recital whether and how he would be affected by approval or denial of the application; where the Utilities Division staff believes that the transaction proposed by the applicant or declarant will adversely affect certain security holders, it makes a deliberate effort to set out the recital in such considerable detail that the persons will be<sup>100</sup> apprised of its possible effects. But the situa-

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100. Much the same problem is raised by applica-  
(Continued)

tion is different where the Commission may impose conditions upon approval. The original notice does not apprise outsiders of such conditions, nor are persons other than the applicant or declarant aided in respect of notice through the informal methods of communication such as conferences and communications.

Practical reasons, however, seem to impel this failure to keep persons other than the applicant or declarant informed of the progress of the case. Before hearing, the conditions which may be sought to be imposed by the staff, or the position sought to be taken are nebulous and wholly tentative; notice thereafter, as the conditions or positions become crystallized, is precluded by virtue of the extreme difficulty of its being effective,

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100 (Cont'd) tions under Section 12 (d) of the Exchange Act for the withdrawal of securities from registration and listing on an exchange. Such withdrawal might often adversely affect outstanding security holders who would thus lose an available market. To inform such stockholders of the various considerations, the notice of hearings summarizes the reasons assigned by the applicant for withdrawal. The Commission is properly insistent that such reasons be sound and complete enough to permit the stockholders to form a judgment as to what position they wish to take and whether they wish to appear. In a recent case, the applicant assigned as one reason for withdrawal the fact that it would thereby save \$2000. Testimony at the hearing disclosed this to be entirely inaccurate; accordingly, the application was temporarily denied and the applicant was required to send new notices stating the facts more accurately.

coupled with the fact that the conferences are last-minute: Where, for example, a declaration concerns the issue and sale of securities (the type of case in which conditions are most likely to be imposed), there is a dead-line for the flotation of the issue to be met, and underwriters will not carry the burden for an indefinite period. Hearing cannot be held any substantial period in advance, since much - including, often, the conditions themselves - depends upon the price at which the securities are to be issued. The price, in turn, cannot be established until a day or two before the date set for the issue; thus a price hearing must be held at that time. Thereafter, to meet the dead-line, negotiations and conferences concerning conditions must follow in short order and the Commission is necessarily precluded from circulating notice of its position and conditions, or from inviting an unidentified group of potentially interested persons to participate in the conferences.

Nor, it is said, is it likely that, in the nature of the cases, the failure of complete notice will create any serious hardship upon the persons who may be interested. The conditions imposed are commonly to protect senior security holders, and result in burdening junior holders. Normally, the junior securities are held by the holding company itself, which either is the applicant or is already present and represented; thus it might well be that the only persons adversely affected are those already notified. On the other hand, where the junior securities are not wholly owned by the holding company, the hardship, again, is more apparent than real. A stockholder has no right to a dividend; whether or not one will be paid lies within the discretion of the management. In the situation here considered, the management acquiesces in the condition imposed; accordingly, the security holder is not in fact injured since the choice has, in any event, been the management's throughout.<sup>101/</sup>

The question of adequacy of notice has

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101. In the case where the junior security holder does have an interest, he may presumably petition for reconsideration. Such a right is not very useful, since the transaction will in all likelihood have long since been consummated. Although the situation has never arisen, it is possible that, in such a petition, the Commission would either find that the stockholder never had a real financial stake in the matter or it might informally effect some arrangement with the holding company whereby dividends will be made available, and its order will be modified accordingly.



recently come to the fore in another type of case under the Holding Company Act - proceedings brought by the Commission under Section 11(b) to enforce the integration and simplification provisions. As in the case of other notices under that Act, the show cause order in 11(b) proceedings originally gave no indication of the Commission's position; it simply recited that the Commission had examined the respondent's structure under Sections 13(b) and 11(a), and that it appeared that the respondent's holding company system "is not confined in its operations to those of a single integrated public utility system within the meaning of the Act, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public utility system." In addition, the show cause order listed the various subsidiaries, sub-holding companies and properties, their businesses and their location; a map indicating the geography of the system was attached. The notice stated neither the precise respects in which the system fails of integration nor the steps which the staff or the Commission might have tentatively believed to be necessary to achieve such integration.

Thus unless the respondent itself comes forward with a plan, it appears that the notice frames only the broad issue of whether the system is integrated

within the meaning of the Act and the narrow issue as to whether the various companies named are subsidiaries, sub-holding companies and properties in the system. Not surprisingly, the propriety of a notice of this nature was challenged. Recently the representatives of one of the systems against which integration proceedings had been brought, objected to the notice on the ground that it was requisite that the respondent be informed by the Commission what the latter believed, on the basis of data available to it, what steps the system was required to take to meet the requirements of Section 11. <sup>102/</sup> It was contended that by so doing, the Commission would give the respondent "something to shoot at" and would thus "save time and money for the government and the companies;" in addition, counsel argued that the order to show cause was "vague" in that it failed to state the Commission's reasons for the alteration of corporate structure or the geographical distribution of the respondents' investments.

That there is considerable merit to this position seems clear. It appears to be unquestionable that at some stage before the Commission's ultimate

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102. See report of oral argument by counsel for the United Gas Improvement Company, New York Times, April 13, 1940.

decision, its plan for integration must be announced and the respondents as well as other interested parties must be afforded opportunity to present evidence and argument thereon. Nor has the Commission intended otherwise; the only question has been at what stage more definite notice should be given. The reasoning which underlay the original form of notice is summarized by Commission officials as follows: (1) That the Commission might lay itself open to a charge of "prejudging the issues," and that it would involve devising a tentative plan before there has been an opportunity for hearing thereon.<sup>103</sup> (2) That even though the Utilities Division staff has been studying the systems for two years, their ideas and the policies of the Commission just now exploring the field, have not crystallized sufficiently to permit of a meaningful tentative plan to be set out in the order. (3) That integration proceedings cannot be tested by standards of ordinary administrative proceedings leading to cease and desist orders. They are, it is suggested, unique

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<sup>103</sup>. In the course of the oral argument presented in the United Gas Improvement Company case, Commissioner Healy suggested that the proposal of a tentative plan in the notice might do violence to "the American way" since the Commission would reach conclusions on an ex parte basis, while Chairman Frank observed that there were dangers of "fickleness" in the contention that there should be such a plan set out: "If we were a slap-dash agency we could easily issue the kind of order to start hearings which you suggest without first reaching sound conclusions." Ibid.

in that Congress in the Act has already found that unintegrated systems are undesirable, and has left to the Commission discretion only to take steps to correct what has already been found to be evil. Thus, it is said, the only question before the Commission is not whether to do anything, but what to do to achieve integration, and this may properly be reserved for a stage in the proceedings later than the initial order for hearing.

If the integration hearing is divided into two stages, the one an "informational" hearing designed to gather together all the views and data, and the second a "decisive" hearing designed to lead to the ultimate order, the arguments set out in the preceding paragraph may be persuasive. But if there is only a one stage hearing leading immediately to the ultimate order, not only does the respondent have no definite issue to meet, and not only will the hearings be likely to be sprawling and interminable, but in addition, the present notice is unsatisfactory from the point of view of outsiders whom the Act declares to have an interest in the matter -- consumers, stockholders, state commissions, municipalities and the like. Though they are entitled to participate, the present form of notice furnishes them no basis upon which they may make an intelligent determination whether they will do so; in the absence of some idea

of what the ultimate order may be, they cannot know whether and how their rights will be affected. The result will be that they will either be put to the burden -- impossibly heavy in the case of consumers and small individuals -- of attending all hearings, ready to step in when anything of interest to them crops up, or staying away altogether.

One can sympathize with the Commission's reluctance to commit itself, even tentatively, at the outset, particularly since, as observed by one of the commissioners, "We are all groping in the dark," on what sort of order might ultimately issue; yet setting up some tentative plan is not unknown to administrative procedure, but rather is a common and necessary device where minimum wages for an industry, or rates for marketing agencies or railroads, or prices for coal, are to be fixed. Concrete notice and a definite starting point cannot properly form a basis for a charge of "prejudgment."

Considerations of this nature have led the Commission recently to decide, upon request, to outline a tentative program for integration prior to hearing (In the Matter of United Gas Improvement Company, HCA Release No. 2065, May 23, 1940). In its opinion, Commissioner Healy dissenting, the Commission declared:

"We consider the notice already given as adequate at this stage of the proceeding. Nevertheless, since the respondents have requested a recitation of the Commission's tentative conclusions...at the outset of the proceeding, and since no person could be injured by such statement, we are willing to enlarge our original notice. Expedition is in the interest of all parties concerned, and we are inclined to agree with the respondent that the issuance of the supplemental notice at this time will probably expedite the conduct of this proceeding."

(2) Communication of notice; publicity.

Sections 8 (b) and 8(d) of the Securities Act prescribe that prior to a hearing leading to a refusal or stop order, notice shall be effected "by personal service or the sending of confirmed telegraphic notice"; Rule 340(d) of Regulation B, relating to offering sheets of oil and gas interests, and Rule 380(d) of Regulation B-T; relating to prospectuses of an oil royalty or similar type of trust also expressly permit service by registered mail; Rule 580(e) of Regulation C, prescribing the procedure for denial of applications for confidential treatment under the '33 Act, specifies only service by confirmed telegraphic notice. In respect of all hearings under the '34 Act and the Holding Company Act, Rule III(a) of the Commission's rules of practice prescribes that "notice shall be given either by personal service, registered mail, or confirmed telegraphic notice".<sup>104</sup>

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<sup>104</sup>. Although its policy has been somewhat wavering, the Commission apparently ordinarily requires personal service in respect of permanent revocation of broker-dealer registrations. In In the Matter of Gerald Owens, 1 SEC 416 (1936), the respondent had, in violation of the Commission's rules, changed his address without notifying the Commission. Notice sent by registered mail was returned unclaimed; efforts to effect actual personal service failed. The Commission accordingly refused permanently to revoke the registration, but issued an order temporarily suspending (Continued)

104. (Continued)

it pending respondent's appearance. The opinion stated:

"We do not decide the effect, under the Rules of Practice, of the notice sent by registered mail since because of the lack of personal service we do not feel that /Respondent's/ registration should be permanently revoked. Yet we are faced with the fact that since the filing of his registration he has thrice been enjoined by courts because of practices in connection with the sale of securities. Obviously it is against the public interest that we permit him to continue to use the mails and the instrumentalities of interstate commerce in making a market in securities. In this situation which arises despite our best efforts to obtain personal service, an appropriate solution can be found in an analogy to well established practice in Equity. There, the Court, ex parte and often without any attempt at personal service, in cases of great urgency or where irreparable injury is threatened, issues temporary restraining orders pending final disposition of litigated matters, permitting those enjoined to be heard at a later date with reference to the lifting of temporary orders issued in this fashion."

But compare In the Matter of S. J. Barlett, 1 SEC 236 (1935), where denial, not revocation, of a broker-dealer revocation was involved. Failure of personal service and of service by registered mail was held not to preclude the Commission from refusing to permit the registration to become effective.

Following the Owens case, the form of broker-dealer registration was amended so as to provide for consent by the applicant to serving of notice by registered mail or confirmed telegram upon a designated agent. In In the Matter of Lewis S. Parsons, 2 SEC 199 (1937), where the application included this amendment, failure to serve the respondent by registered mail was held not to preclude permanent revocation since "by virtue of his consent, the sending of notice by registered mail to Parsons at the address at which he directed notices be sent satisfies the requirement of appropriate notice." But the Commission receded from this position in In the Matter of William Reid (Continued)



In addition, the Commission has provided for other methods of notices in particular cases. In matters arising under the Holding Company Act, municipalities, State commissions and States potentially interested are notified by ordinary mail or telegram. Where an issuer applies to withdraw his securities from listing on an exchange under Section 12(d) of the Exchange Act, the issuer is ordinarily required to mail notices to all stockholders. In applications by an exchange for such withdrawal, while there is no such requirement, at least the New York Stock Exchange, which itself holds hearings prior to making its application, gives notice through its ticker tape service.

Only in the case of hearings on applications for confidential treatment is the notice not made public; where the hearing is a "matter of public interest" (e. g., applications for

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104 (Continued)

Taylor, 3 SEC 1085 (1938) and In the Matter of Ralph H. Gibbins, 4 SEC 29 (1938), where it held that it could not permanently revoke registration if respondent has not been served personally and has not received notice by registered mail, even though notice was sent in accordance with the consent provided in the amended form.

Thus it is apparent that at present the Commission's position is that either personal service or actual service by registered mail (return receipt signed by respondent) upon respondent is necessary before there can be permanent revocation.

withdrawal of registration for trading on an exchange, applications and declarations under the Holding Company Act and the like), the notice is widely circulated in the form of press releases, through mailing to the many thousands of persons on the Commission's general and special mailing lists, and finally by publication in the Federal Register.<sup>105</sup> The practical consequences of the publicity which accompanies such notice is worthy of note. As described by a former Chairman of

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105. The list of matters in respect of which notice of hearing is published in the Federal Register includes those relating to the registration, or exemption or withdrawal from, or suspension of, registration of national securities exchanges; those relating to withdrawal and striking from listing and registration of a security registered on a national securities exchange, or the granting, denying, termination, or suspension of unlisted trading privileges; those relating to proceedings brought by the Commission to deny, suspend the effective date of, suspend, or withdraw the registration of a security; those relating to proceedings brought by the Commission to expel or suspend any member or officer from a national securities exchange; those relating to suspension or revocation of a broker-dealer registration where attempted service of such notice personally or by mail has been unsuccessful; and all those relating to hearings under the Holding Company Act.

In addition, notice of the institution of stop and refusal order proceedings under the '33 Act is published in the "Registration Record", in the form of daily releases and a periodical index, which are sent free of charge to all members of the public so requesting, to 800 publications, and to all State security commissions.

the Commission, "the initiation of a complaint is public. Of itself it is an attack upon the conduct of the respondent. Situated as the administrative is at the center of news distribution in this country, the complaint receives wide publicity, frequently far wider than its disposition receives." Accordingly, where the sale of or dealing in securities is involved, the suspicion which attaches to a public notice may effectively do the damage before the final order.<sup>106</sup> The question, thus, is raised whether, where the Commission proceeds on its own motion, public notice of the charges should be suppressed. At least one circuit court has indicated that such suppression would be desirable. In a delisting proceeding brought by the Commission, it was alleged that the registration statement

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106. Landis, op. cit. supra, note 8, p. 110.

See the statement, previously quoted in another connection of the Commission's General Counsel to the effect that "whether the SEC on final consideration will actually decide to enter a stop order is interesting, but not very important, for only a rare investor would purchase securities from an issuer threatened with an administrative bar. Where the SEC actually delists a security, the news is important; but the market drops when the order for hearing is announced." But a survey following the publication of the gravest of charges against a bank purports to show that for a three-months period after the notice, deposits in the bank increased. 7 U. of Chi. L. Rev. 150.

contained false statements in respect of the condition of a bank, a subsidiary of the registrant, and that serious financial malpractices had been committed. The allegations were based at least in part upon information which the Commission had obtained from the confidential bank examination reports of the Comptroller of the Currency. The Court of Appeals for the District of Columbia stated in the course of its opinion that<sup>107</sup>

"The order for hearing . . . set out the particulars of the subjects to be investigated, together with all the facts believed by the Commission to show the respects in which Transamerica's statement of the condition of the Bank was believed to be untrue. The specifications of alleged misconduct are . . . set out in such meticulous details as backed by the great power of the Commission, to cause serious prejudice to the Bank and bring it, in advance of any hearing, into public disrepute. . . .<sup>108</sup> There is nothing in the Act which authorizes publicity in advance of hearing. . . . Notice of hearing must be published in the Register, but the rule does not require the publication as part of such notice of the evidentiary facts; and where, as in this case, the latter are obtained from confidential sources, neither the purpose nor intent of the Act contemplates their broadcast to the public. It is not difficult to see that such a power might easily be made an instrument of oppression and, lacking specific congressional authorization, we think it ought not to be indulged. . . . Certainly until findings are made, the Bank . . . is entitled to have judgment, public and official, suspended."

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<sup>107</sup>. Bank of America National Trust & Savings Ass'n. v. Douglas, 105 F. (2d) 100 (1939).

<sup>108</sup>. But compare the findings of a law review commentator that in fact this bank's deposits rose after the notice. See supra, note 106.

That the power to publicize notice is an immense one capable of improper use is unquestionable; further, in the peculiar circumstances of the Bank of America case, suppression might well have been desirable.<sup>109</sup> Yet publication of notice is a common administrative practice among the agencies. In 1925, the Federal Trade Commission abolished its policy of issuing explanatory statements accompanying its complaints, but the practice was resumed in 1934 and has continued since. The National Labor Relations Board, the Federal Power Commission, and other agencies, make their complaints a matter of public record; the Interstate Commerce Commission, on the other hand, permits the carrier named by a complainant to satisfy the complaint or answer it privately without publicity.

Yet it may be conceded that the subject-matter with which the SEC deals is likely to be more than ordinarily sensitive to adverse publicity. Proceedings begun by the Board of Governors of the Federal Reserve

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109. As described above, note 93, apparently in response to the criticism of the court, the Commission's recent notices have omitted the clause that it has "reason to believe" that certain facts are true, and has substituted the clause that its staff "informed" it of such facts. The notice does not indicate the position of the Commission at all. But it is doubtful that the reader will make this distinction and that, if the problem is a serious one, the change of phraseology serves as a successful solution. As already noted, it may be that the Bank of America case does no more than require the casing of a notice in terms of "whether" specified facts are true, instead of in terms of "belief" of "information" of their truth.

System and the Comptroller of the Currency, both of which deal with a class of business in some respects analogous to that with which the SEC deals, maintain strict secrecy. But two important factors may be noted as justifying the Commission's policy of publicity in the normal case: First, it is abundantly clear that the Commission takes extraordinary precautions before instituting decisive proceedings. As already described, investigation, both formal and informal, are utilized; negotiations and conferences are held; and the commissioners themselves scrutinize recommendations to proceed to decisive action with considerable care. As a result, the case is thoroughly rounded out before there is any publicity, and there seems to be adequate safeguards against hasty action. How carefully the Commission proceeds to decisive action where violations are concerned is indicated by the fact that, so far as is ascertainable, no case of this nature has yet been dismissed on the merits and in the absence of correcting amendments. Under these circumstances, the danger of harm by publicity to a respondent who might ultimately be found innocent seems remote. Second, there are affirmative considerations of policy which support the policy of publicity. Where, after its careful preliminary researches, the Commission is of the opinion that violations exist, it would seem to be contrary to the

intent of the Acts that the Commission should keep this secret and permit investors, for whose protection the Acts were passed, to continue to be defrauded. It would appear that, normally, investors are entitled to be forewarned; the danger of unscrupulous operators' engaging in hit-and-run tactics is such that by the time the ultimate administrative decision is issued, the consolation to the investor may be small. In sum, except in unusual cases, the beneficial results of forewarning and timely disclosure would appear to outweigh the possibilities of unfairness to particular respondents.

(3) Amendments. Rule IV(a) of the Commission's Rules of Practice requires that in stop or refusal order proceedings under Section 8 of the '33 Act items in the registration statement which appear to be defective but are not particularly specified in the notice must be so specified by amendments to the notice prior to the taking of testimony in regard to such items. Motions to amend in Section 8 proceedings, if made at the hearing (and because of the speed with which such actions are brought and the likelihood that new defects may appear in the course of the hearing, such motions are fairly common) shall be in writing and may be passed upon by the trial examiner. If the motion to amend is granted,

and upon request of the registrant, the examiner "shall grant a reasonable time within which the registrant may familiarize himself with such matters before taking testimony in regard to such items." In respect of proceedings instituted by the Commission other than those under Section 8 of the '33 Act, Rule IV(b) provides that "amendments may be allowed to the order, rule to show cause or other moving papers by the Commission on application to it, <sup>110</sup> or upon its own motion."

The same rule further provides that "when issues not raised by the pleadings of the party or the Commission's statement of matters to be considered and determined are tried by express or implied consent of the parties, they may be treated in all respects as if they had been raised by the pleadings." The rule is sparingly used and under normal circumstances, the Commission requires that the pleadings expressly raise the issue; in the event, however, that the registrant consents in broad terms to the issuance of a stop order, and the new defects are closely related to defects alleged, the Commission may make

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110. Comment concerning the lack of the trial examiner's powers in these respects is reserved for a later discussion of his powers in general. Infra, pp. 189-190.



findings on such unalleged but litigated issues.

Except in the event that the motion to amend is not timely and may prejudice the respondents, such motions are customarily granted. Two cases serve to illustrate the permissible limits of these motions. In In the Matter of South Umpqua Mining Co., 3 SEC 224 (1939), Commission counsel moved, at the close of the Commission's presentation of its case, to conform the pleadings to the proof by amending the statement of matters to be considered with respect to specific items and by including new items. The motion was made on August 17; it was granted and the trial examiner also granted a series of continuances until November 1 to permit the registrant to prepare and adduce rebutting evidence on the new charges. The Commission overruled the registrant's objections to the granting of the motion to amend, since the continuances prevented the motion from working any unfair hardship upon the registrant and from causing surprise to him. On the other hand, in In the Matter of Virginia City Gold Mining Co., 2 SEC 855 (1937),

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111. E. g., In the Matter of Continental Distillers & Importers Corp., 1 SEC 54, 81 (1935). But even where it is not apparent that registrant objected to the litigation of issues not pleaded, the Commission may disaffirm the trial examiner's findings of deficiency in respect of such items. In the Matter of Metropolitan Personal Loan Co., 2 SEC 803 (1937); cf. In the Matter of Austin Silver Mining Co., 3 SEC 601 (1938).

Commission counsel did not move to amend so as to include new deficiencies until the close of the hearing, and without prior notice. The Commission sustained the registrant's objections to the motion without prejudice to the institution of further proceedings based upon the alleged deficiencies enumerated in the motion; it held that since the motion was not timely, the registrant "would be prejudiced by granting the motion to amend."<sup>112</sup>

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112. After the initiation of stop order or delisting proceedings in respect of registration statements, it is not uncommon for the registrant to submit amendments to cure the alleged deficiency. Whether or not such amendments, even if they cure the deficiency, will halt the proceedings is held to be within the discretion of the Commission. Thus in In the Matter of Haddam Distillers Corp., 1 SEC 37, 47 (1934), the Commission stated:

"The Commission . . . can in its discretion consider the situation as of the time of the issuance of the order and not limit itself to a consideration of the record at the time of the notice of the initiation of the proceeding. But the circumstances attendant upon the present case clearly give no warrant to the Commission to exercise its discretion in order to permit the registrant to escape the consequences of a neglect and folly that approaches fraud. Trusteeship of other people's money, which the registrant in offering its securities to the public seeks to assume, demands. . . . some warrant of open, fair, and careful dealing. The registrant has twice failed to meet that criterion. Now that the deficiencies have been called forcibly to its attention it hopes by curing them to retain its right to sell securities. But it should certainly not acquire that right under these circumstances when this Commission has the power to transmit generally (continued)

Answers: default proceedings. With the single exception noted below, the Commission neither requires nor provides for the filing of answers; nevertheless, respondents may, and not infrequently do, file answers which, it is said, 'have no significance in the administrative proceedings.' The major reason assigned for the failure to require answers is that such answers would normally consist of little more than blanket denials in those cases where issues of fact are involved, while in cases where the facts are not in issue, an answer as to the law or policy would be of little use. Further, through deficiency

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112 (Cont'd)

to the public this evidence of the registrant's disregard of fundamental business ethics and this evidence of unconscionable pretense of scientific method by an appraisal company. A nation of investors deserves, at least, this slight protection."

In contrast, however, in proceedings in respect of offering sheets of oil and gas interests, or prospectuses of an oil royalty trust, if an amendment filed before the hearing is finally closed, but after the initiation of action, is found to cure the defect, the Commission will terminate the proceedings. Reg. E, Rule 340(c); Reg. E-T, Rule 380(c).

In any event, it is to be noted that a stop order remains in effect only so long as the deficiencies are not cured. Thus, once the order has issued, the amendments must be considered and if proper, the order will be lifted. Cf. In the Matter of Haddam Distillers Corp., 1 SEC 48 (1934). The procedure for examining such amendments is the same as that for examining the original registration, except that the Commission itself must consider them and the order for lifting the stop order must be issued by it. If the amendments themselves are improper and are not corrected after deficiency letters, formal proceedings are again instituted. Such amendments cannot be finally denied effectiveness without a hearing.

letters and other informal negotiations, it is customary for the issues to be framed by the time hearing is begun and, accordingly, answers are unnecessary and may serve only to delay where prompt action is desirable. On the other hand, however, some Commission officials state that especially in cases involving broker-dealer registrations, answers, when filed, have been helpful in further framing the issues; but it is to be noted that in respect of this type of case, negotiations and pre-hearing conferences are not utilized to so great an extent as in other proceedings. Finally, wasteful litigation of uncontested issues is avoided even in the absence of answers either by the not infrequent stipulation by respondents that certain facts are true, or that certain items in the registration statement are false, or by the filing of amendments.

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In integration and simplification proceedings

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113. Nor do answers seem necessary in cases not begun by the Commission, but where the contest, if any, is between outside parties. Thus, on applications for termination of unlisted trading privileges, the contest may be between a broker and an exchange, or on applications for withdrawal from registration for trading on an exchange, the issuer and the exchange may be the parties to the contest. But formal answers by objectors are scarcely necessary since in this type of case the issues are, in any event, narrow and well-defined by statute, and the objectors - e.g., stockholders - ordinarily write in their objections to the granting of the application in advance of hearing. See infra, p. 209-210.

begun by the Commission under Section 11(b) of the Holding Company Act, the Commission has adopted the policy of requiring answers to be filed by the respondent system. The notice of order to show cause in such cases demands answers "admitting, denying or otherwise explaining their respective positions as to each of the allegations contained in the Notice and order"; as described above (p. 128), such allegations concern simply the facts of the system's structure and the absence of integration. In addition, the answer may, but is not required to, include a "statement of the respondent's claims as to (a) the action which is necessary in order to limit the operations of each of the respondent's registered holding companies to a single integrated public utility system, and (b) the extent to which any of such companies should be permitted to control additional integrated systems or to retain interests in other businesses" (notice of and order for hearing, In the Matter of Electric Bond and Share Co., February 28, 1940). Thus far, the majority of the answers have consisted largely of denials of lack of integration; in at least one case, however, the system responded by presenting in its answer its general plan looking toward integration and simplification. The purpose of answers in these proceedings is said to be to narrow the issues, if possible, but the respondents are not in any sense

limited by their answers. The problem of the effect of failure to answer, and whether such failure would be treated as an admission of the allegations, has not yet arisen.

In each case brought thus far, approximately 40 days have been permitted for the filing of answer; the time has been extended in a number of cases for a week or two weeks. In one case,<sup>114</sup> the respondents applied for a 90-day extension of time, contending that the respondents (the several companies in the system as well as the system itself) are separate corporate entities with principal offices in various states; that the business is wide-spread and extensive; that "in order to make answer to the 136 paragraphs of the Notice and Order it will be necessary for respondents' counsel to make further detailed inquiry of the respondents, to communicate with them by questionnaire or otherwise, and to study in detail their individual operations and also the interconnections now existing between certain of them and certain companies which are not respondents; that in addition to the factual material necessary to enable respondents to answer

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114. In the Matter of Electric Bond and Share Company, Holding Company Act Release No. 2038, April 30, 1940.

the allegations of the Notice and Order, it is necessary for the respondents to consider the extent to which it is possible or practicable to make response with respect to matters concerning which a response is permitted"; and that, accordingly, answer within the time limits was impossible. This application was denied by the Commission in an opinion pointing out that the first 135 allegations in the notice merely set out the identity of the respondents, their parent-subsidiary relationships, the types of business engaged in, and "similarly uncontroversial matters", so that "if any erroneous statements of fact have been made, a brief scrutiny of records in the New York offices would unquestionably suffice to disclose the error." Nor, the Commission stated, was "extended research" necessary in respect of answering the 136th allegation - that the system was not an integrated one. Finally, the respondents did not indicate that they planned to formulate and present any such program as the notice permitted, and, therefore, no further time was necessary in that respect.

It would seem that the Commission is on sound ground and that 40 or 50 days are normally sufficient: It must be on its guard against attempts further to avoid the integration which the

Act had found to be necessary - especially in view of the contention of some observers that the process has already been too long delayed. Further, it seems fair to note that the holding company systems have, in fact, had far more than 40 to 60 days to prepare themselves; for practical purposes they have had over three years during which they have been aware that the facts of their structure would be litigated and that plans for simplification and integration would be required to be formulated; in addition, throughout this period, the companies have had the opportunity (of which a large majority has taken advantage) to file voluntary integration and simplification plans under Section 11 (e). Under these circumstances, the 40 to 60 day requirement does not appear to be harsh in the absence of special considerations.

In part as a practical matter because of the absence of a requirement of answers, in part in deference to the theory that the Commission must find violation before it can issue a decisive order, in the usual case the respondent's failure to appear or otherwise defend himself, after notice is received, does not result in the Commission's dis-



pending with a hearing. Rather, the Commission proceeds to put in its case by the customary formal methods before a trial examiner and thereafter the hearing is closed. Nor is it rare for respondents to fail to appear; failure occurs occasionally in stop order proceedings, and rather frequently in cases involving the revocation of broker-dealer registrations (where the respondent may not appear simply because he is in jail).

The considerations concerning the necessity and desirability of holding hearings where the respondent fails to contest have already been discussed above in this monograph (supra, pp.76-77) and in other monographs prepared by this Committee's

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115. In the discretion of the Commission, however, a stop order hearing may be suspended and an order issued on the basis of the allegations where the respondent consents to such an order and expressly admits the allegations contained in the stop order notice. In the Matter of Strong Lease and Mining Co., 1 SEC 121 (1935); but Cf. In the Matter of Big Wedge Gold Mining Co., 1 SEC 98 (1935), where, despite respondent's consent to the issuance of an order, the hearing continued. And in application cases where the applicant fails to appear, the application will be dismissed because of applicant's failure to meet his burden of proof. In the Matter of Teck-Hughes Gold Mines, 2 SEC 400 (1937) (application by issuer for withdrawal and striking from listing; the application was opposed by the exchange).

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staff. There is little need further to labor the point. Where, as here, the statutes require only "opportunity for hearing" there seems to be express legislative sanction for dispensing with hearings where the respondent shows no disposition to utilize them. It is perhaps true that in fact the Commission loses little time or expense in holding hearings in each individual case, since the situation arises most often in respect of broker-dealer registration hearings where both the participating Commission counsel and the trial examiner are stationed at the regional office at which the hearing is held; still, the work-load of the Commission and its staff is, as already noted, enormous, and this would seem to be one of the burdens of which it could reasonably be relieved.

Indeed, in exemption and other special cases, the Commission has adopted procedures which recognize these considerations. The frequency with which respondents failed to appear in proceedings to suspend offering sheets of oil and gas interests

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116 Federal Alcohol Administration, Monograph No. 5, pp. 33 - 36; Federal Communications Commission, Monograph No. 3, p. 31; Federal Deposit Insurance Corporation, Monograph No. 14, pp. 75 - 76; Federal Trade Commission, Monograph No. 6, pp. 32 - 33; Post Office Department, Monograph No. 13, pp. 55 - 59.

ultimately led the Commission to adopt a rule under which a permanent order will be issued forthwith unless the person filing the offering sheet makes written request for a hearing (Reg. B, Rule 340; semble, Reg. B-T, Rule 380, relating to prospectuses of oil royalty trusts). Similarly, as described above (p. 105), Rule X - 12 D3 - 8 (c), dealing with the revocation of the registration of unissued securities for "when issued" trading, provides that if 40 days have elapsed after the Commission has sent a notice of deficiency, and neither the issuer nor the exchange makes written request for a hearing to determine whether the registration shall become effective, the registration is deemed to have been withdrawn.

The procedures utilized in these cases seem to be adaptable to other proceedings brought by the Commission. Of course no order could issue against a non-appearing respondent in the absence of a hearing under the present rules. It would be necessary to include in the notice an announcement that opportunity for hearing is to be afforded in respect of the allegations at a stated time and place; that such hearing will be held if timely request therefor is made; and that an order may issue against respondent without a hearing in the absence

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of request therefor. It is submitted that,  
given a notice of this nature, statutory require-  
ments are fulfilled, and considerations of fair  
play and cautious safeguarding of individual rights  
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are preserved.

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117 Discretion should, of course, be left in the Commission to hold hearings, even where none is requested, where publicity and extensive public findings are thought to be desirable; this would forestall a respondent's attempt to avoid full public disclosure by the simple process of not requesting a hearing.

118 Again it may be recalled that so far as can be ascertained no case in the nature of a complaint has ever been dismissed by the Commission on its merits after hearing and in the absence of correcting amendments - whether or not respondent appeared.

Parties: (1) Those specifically notified.

Persons receiving notice in cases heard by the Commission vary with the type of proceeding being conducted. In the simplest cases, involving, for example, denial or revocation of a broker-dealer registration, only the respondent is directly notified. Similarly, in cases involving refusal or stop orders under Section 8 of the Securities Act, only the agent designated by the registrant to receive service is sent notice directly;<sup>119</sup> the appraiser or other experts who participated in the preparation of the registration statement, and who may be civilly liable, must depend upon public announcement or upon communication from the registrant for appraisal of the proceedings. However, if the work of such experts is an issue at the hearing, they will almost certainly be called as witnesses by the Commission or the registrant; they do, in fact,

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119. Section 8(f) of the Securities Act provides: "Any notice required under this section /governing stop or refusal orders/ shall be sent to or served upon the issuer, or, in the case of a foreign government or political subdivision thereof, to or on the underwriter or on its duly authorized representative in the United States named in the registration statement....." Rule III(b) of the Rules of Practice prescribes that stop or refusal order notices shall be given "to the person designated in the registration statement....."

therefore almost invariably receive actual notice. Further, of course, in all other cases under the three Acts, notice is served upon the particular person proceeded against, or the applicant, or the declarant as the case may be.

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Many of the hearings held by the Commission, in addition, immediately affect persons other than those proceeded against or those initiating the proceedings by application, declaration, or registration statement; accordingly, in many such cases, either Congress or the Commission has provided for direct notice to such other persons. Thus in proceedings brought by the Commission to delist a security under Section 19(a)(2) of the Exchange Act, notice is given to the exchange as well as to the registrant's agent for service. In proceedings under Section 12(f) of the Exchange Act begun by application to extend or terminate unlisted trading privileges, that section requires that the applicant, the issuer of the security, the exchange, and any other exchange on which such security is listed or admitted to unlisted trading privileges must be notified.

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120. "Whenever a hearing is ordered by the Commission in any proceeding, notice of such hearing shall be given... to the registrant, applicant, or other parties to the proceeding, or to the person designated as being authorized to receive notices issued by the Commission." Rules of Practice, Rule III(a).

Where an issuer applies for withdrawal of listing under Section 12(d) of the Exchange Act, the exchanges upon which the securities are listed are notified, and, in addition, the issuer is ordinarily directed by the Commission to notify the stockholders;<sup>121</sup> if the applicant is the exchange, however, only the issuer and other exchanges, but not the security holders, are required to be specifically notified.<sup>122</sup>

Finally, under the Holding Company Act, special notice may be furnished to a number of persons other than the respondent, applicant, or declarant. In a case involving applications for approval of a voluntary reorganization and simplification plan, the applicant was required to send notice of hearings to all shareholders of record of the applicant's three subholding companies In the Matter of Massachusetts

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121. Rule X-12D2-1(b)(2). In one case, where the issuer was the applicant, no such requirement was made inasmuch as the security in question was and continued to be registered in another exchange.

122. The applicant exchange is not required to circularize the stockholders, since it is felt that this would place too great a burden upon it. But several applicant exchanges attempt to persuade the issuer to transmit the notice; and the New York Stock Exchange's policy is to send notice over the ticker tape before it makes its application.

Utilities Associates et al., 3 SEC 1 (1938)7. In hearings involving the organization and operation of a subsidiary service company, or declarations to issue and sell securities, or integration and simplification proceedings, or voluntary reorganizations, state commissions and mayors of municipalities served by the utility are expressly notified and informed that "Any comment you may wish to make will be appreciated." Customarily, too, companies related to the applicant are expressly given notice.

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(2) Intervention: (1) By whom. Section 19 of the Holding Company Act provides that

"In any proceeding before the Commission, the Commission . . . shall admit any interested State, State commission, State securities commission, municipality, or other political subdivision of a State, and may admit as a party any representative of interested con-

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123. In In the Matter of Safety Engineering and Management Co., 3 SEC 954 (1938), however, the usual requirements were suspended because of special circumstances: The application was for the exemption of a security issue involving the renewal of notes which were to mature on October 1, 1938. Applicant's efforts to raise funds to meet the notes failed at the last moment; it therefore filed its application on September 28, 1938. The Commission, in its opinion, stated that "Since the exemption requested is merely for the purpose of permitting the renewal of the notes for a period of sixty days/ . . . the Commission deemed that no person . . . had a sufficient interest to warrant delaying consideration of this matter for the purpose of giving the customary published notice of hearing. Accordingly, hearing was held without notice other than to the applicant."



sumers or security holders, or other persons whose participation in the proceedings may be in the public interest or for the protection of investors or consumers." (Underscoring supplied).

Similarly Section 12(f) of the Exchange Act, relating to applications for the extension or termination of unlisted trading privileges, provides that "In any proceeding under this subsection . . . any broker or dealer who makes or creates a market for such security, and any other person having a bona fide interest in such proceeding, shall upon application be entitled to be heard." In addition, in respect of any hearings under the several Acts, Rule XVII(a) of the Commission's Rules of Practice provides that:

"Any interested representative, agency, authority, or instrumentality of the United States, and any interested State, State commission, State securities commission, municipality, or other political subdivision of a State, shall be permitted to intervene on written request. Any other person may be permitted to intervene in any proceeding upon written application to the Commission showing that he possesses or represents a legitimate interest which is or may be inadequately represented in such proceeding but no person will be permitted to intervene if after examination the Commission finds that for any reason (including the existence of undesirable conflicts in the interests possessed or represented by the applicant), his participation in the proceeding would not be in the public interest, or for the protection of investors, or in a proceeding under the Holding Company Act, for the protection of consumers. Intervention shall be subject to such terms and conditions as the Commission may prescribe,

which may include a requirement that the applicant divest himself of specified interests which might conflict with the interests upon which his intervention is based."

Rule X-12D2-1(3)(b)(2), governing proceedings on applications for withdrawal of registration of securities for trading on exchange, provides that all holders of such securities have "a right to present their views by appearing at [the] hearing . . . on the subject of what terms, if any, should be imposed for the protection of investors in granting the application."

Pursuant to these statutory provisions and its rules and regulations, and in accordance with its expressed solicitude that proceedings "be so conducted that all pertinent points of view receive consideration and that investors be given an opportunity to protect their interests,"<sup>124</sup> the Commission has been liberal in affording rights to intervene, although in fact, despite the broad rights to do so, intervention is somewhat infrequent.<sup>125</sup> It should be noted that, in addition to granting rights to intervene, the Commission

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124. In the Matter of Utilities Employees Securities Co. and New England Capital Corp., 3 SEC 865 (1938).

125. Intervention appears to occur most frequently in Holding Company Act cases involving fees, remunerations and expenses in reorganization proceedings, in voluntary integration cases, and in applications to approve reorganization plans. Under the Exchange Act, intervention is not rare in Section 12(d) (withdrawal of listing) and 12(f) (extension or termination of unlisted trading privileges) proceedings.

sometimes affords opportunity to be heard, to participate, and to examine and cross-examine witnesses. The precise difference in fact between such participation and intervention is not clear, especially since, under the Holding Company Act where this form of participation most frequently occurs, persons other than parties may appeal. It is stated that intervention is likely to be allowed where a pecuniary interest is involved; the right to be heard will be granted in  
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other cases.

(ii) Procedure for intervention. Under Rule XVII(a) of the Rules of Practice written request to intervene is stated to be necessary, even when made by an instrumentality of the United States or others whom the rule or the Acts declares shall be permitted  
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to intervene. Subsection (b) of the same rule provides that:

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126. Cases of the Commission treating of problems of intervention are set out in Appendix E, pp. 341-344.

127. It was formerly the practice to permit such groups to intervene merely through appearance. Cf. In the Matter of American Water Works Co. Electric Co., 2 SEC 972 (1937). It is customary for notices of hearing to include a request that "any person desiring to be heard or to be admitted as a party to such proceedings shall file a notice to that effect with the Commission on or before" a specified date, usually three days before the hearing. Failure so to notify does not preclude participation or intervention.

"Any person filing an application to intervene shall file therewith an affidavit setting forth in detail his interest or the interest to be represented by him in the proceedings, and stating whether the position which he may propose to take with respect to the pending matter is one already taken by any other party to the proceedings. In the case of a person desiring to intervene in a representative capacity, his affidavit in addition (1) shall state all relevant material facts bearing upon the existence of any interest of the applicant or of any person represented by him which may conflict with the interests of any other person represented by him, including all affiliations of the applicant or of any person represented by him with any other party to the proceedings; (2) if requested by the Commission shall state the names and addresses of the persons represented; and (3) shall be accompanied by copies of all circulars, other general literature, and forms of authorization used or intended to be used by the applicant."

In addition, the trial examiner or the Commission may, upon request of any party or of counsel for the Commission, order the applicant to submit himself for examination with respect to his application.

Although these rules may seem to be somewhat elaborate and complex, the danger, especially in Holding Company Act cases, of lack of complete disclosure in representation, and the demands for a proper representation of conflicting interests (see the Utilities Power and Light cases, infra, Appendix II

pp. 342-343, seen fully to justify the Commission's safeguards. And, in addition, it is to be noted that where such danger and demands are absent, and where the petitioner is recognizedly a person with interests to protect, the formal requirements may be waived. Thus, where there is an application by an issuer or an exchange to withdraw securities from registration and strike them from listing, stockholders have a right to be heard under the '34 Act, and are permitted so to be heard without being required to intervene formally. Similarly, in proceedings under Section 12 (f) of the Exchange Act to extend or terminate unlisted trading privileges, any broker or dealer who makes or creates a market for the security involved is treated as a party on mere appearance; Rule XVII is not applied so as to require such a person to intervene formally. The same is true in stop order hearings under Section 8 (a) of the Securities Act, and under Regulations B and E-T, where, since persons responsible (underwriters, accountants, engineers and the like) for portions of the registration statement, offering sheet or prospectus, are regarded as parties in interest, full participation

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is permissible without formal intervention.

The actual procedure for considering motions to intervene or to be heard varies from case to case. Only the Commission has power ultimately to determine such motions; and, with the assistance of the staff, does so where the application is made before the hearing. If, however, the motion is made at the hearing, the trial examiner may either transmit it to the Commission forthwith or may reserve ruling thereon and permit the petitioner to participate in the meanwhile. The latter seems to be the more common method and its result is apparently to give the examiner de facto power and, regardless of the Commission's decision when the case is finally decided on its merits, gives the petitioner full rights. Since petitions of this nature must be decided promptly before the hearing progresses very far, and since the examiner in fact exercises the power to rule on such petitions, there seems to be no compelling reason why he should not be formally vested with power in the premises, reserving his right, of

128. E.g., In the Matter of Continental Distillers and Importers Corp., 1 SEC 53, 55 (1935)  
(appraiser permitted to participate although no application was filed).

course, to consult with his superiors in complex or novel cases.

(3) Representation of parties. Any person appearing before the Commission may, under Rule II (b) of the Rules of Practice, be represented in any proceeding by an attorney. Although formerly attorneys were required to be admitted to the Commission bar, this has since been abandoned. To qualify as a representative, the attorney must have been admitted to practice before the Supreme Court of the United States, or the highest court of any state or territory, or the Court of Appeals or the District Court of the United States for the District of Columbia. In addition, Rule II(a) permits an individual to appear in his own behalf; a member of a partnership may represent the partnership; a bona fide officer of a corporation, trust, or association may represent the corporation, trust, or association; and an officer or employee of a commission or of a department or political subdivision of a state may represent a commission or political subdivision of the state. Representation except under these circumstances is forbidden; further, any person appearing before or transacting business with the Commission in a representative capacity may be required to file with the Commission

a power of attorney with the Commission showing his  
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authority to act in such capacity.

Normally, persons are represented by counsel in decisive proceedings before the Commission, although sometimes in cases involving revocation of broker-dealer registrations or stop orders, the respondents may appear pro se. Brokers, dealers,

129. To prevent lobbying, legislative and otherwise, or at least to achieve disclosure of interest, Section 12 (i) of the Holding Company Act requires that all persons employed or retained to represent a registered holding company or its subsidiaries before Congress, the SEC, or the Federal Power Commission, shall file a statement with the SEC, disclosing the matters in connection with which they are employed or retained, the nature and character of such retainer or employment, and the amount of compensation to be received, directly or indirectly, in connection therewith. Every person so employed or retained must file with the Commission ten days after the close of each calendar month during such employment or retainer a statement of the expenses incurred and the compensation received during each month. This requirement has been interpreted by the Commission (HCA Release No. 84) as applying if the person retained seeks to affect the exercise of discretionary powers by members of Congress, the SEC, or the FPC. If the attorney or other person simply acts for his client in obtaining advice as to the application of the Act, or prepares registration statements, formal applications or similar documents to be filed, the requirements are inapplicable. See Throop, Practice Before the SEC (Sept. 1937) 4 D.C. Bar Ass'n. J. 4, 17. During the fiscal year ending July 1, 1939, 357 statements were filed pursuant to Section 12 (i).



and interested investors are not ordinarily represented by counsel when they intervene in proceedings involving applications to withdraw from listing, or to extend or terminate unlisted trading privileges. Similarly, individuals seeking merely to be heard in Holding Company Act cases are not customarily represented by counsel. In general, it is stated, the Commission prefers that parties be represented by counsel in decisive proceedings; in cases brought by the Commission against respondents, the Commission expressly advises respondents of their right to counsel.

Rule II(c) of the Rules of Practice empowers the Commission to disqualify, and deny, temporarily or permanently, the privilege of appearing or practicing <sup>130</sup> before it in any way to any person who is found by the Commission after hearing in the matter (1) not to possess the requisite qualifications to represent others, or (2) to be lacking in character or integrity or to have engaged in unethical or improper professional

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130. "Practicing" includes "the preparation of any statement, opinion or other paper by any attorney, accountant, engineer or other expert, filed with the Commission in any registration statement, application, report or other document with the consent of such attorney, accountant, engineer or other expert." Thus under the terms of this rule, the  
(Continued)

conduct. Further, contemptuous conduct at any hearing before the Commissioner or a trial examiner shall be ground for exclusion from the hearing and for summary suspension without a hearing for its duration. No occasion has yet arisen to invoke the power to disbar or otherwise discipline an attorney; <sup>131</sup> in general, the attitude of counsel is respectful and the hearing dignified and without the bitterness and unseemly tactics which sometimes mar administrative hearings.

Hearings: time and place. In the case of a refusal order under Section 8 (b) of the '33 Act, the statute requires that the hearing be within ten days after notice; similarly, stop order hearings must follow the notice within 15 days. Hearings on applications for confidential treatment

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130. (Cont'd.) Commission has the broad power to disqualify an accountant, for example, whose work it has found to be inaccurate to such a degree as to fall within clause (1) of the grounds for disqualification.

131. In one instance, the Commission brought a proceeding to determine whether an accountant, who was alleged to have held himself out as an officer of the Commission, should be barred from practicing as an agent before the Commission. Hearing was held before a trial examiner, a report was filed, and exceptions and oral argument before the Commission were had. The Commission, in a formal written opinion, dismissed the proceeding for lack of substantial evidence.

In another instance the Commission instituted  
(Continued)

under the same Act are required to be within ten days after notice; 20 days after request for hearing are permitted in the case of suspension of offering sheets and prospectuses. It will be noted that in these cases, maxima are set because speed is to the interest of the respondent, since the mere institution of proceedings may postpone the effective date of the statements, offering sheets, or prospectuses, or the institution of proceedings may put a cloud upon the securities to be sold.

In other cases, minimum rather than maximum periods are prescribed: Section 12 (f) of the Exchange Act provides that in any proceeding involving the extension or termination of unlisted trading privileges "notice of not less than ten days . . . shall be deemed adequate notice," while as to all hearings, Rule III(a) of the Rules of Practice requires that notice shall be given "a reasonable time in advance of the hearing". It is stated that the Commission regards "a reasonable time" as being a minimum of ten days, but

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131. (Cont'd.) an action in a federal court to enjoin an attorney formerly on its staff from continuing to represent a respondent in a proceeding before the Commission, on the ground that the attorney had acquired familiarity with the case while on the Commission's staff. The injunction was issued both against the former attorney and against his new employer.

where the applicant makes an urgent request for speed, and where the statute does not otherwise direct, a hearing may be as little as seven days after notice. In proceedings brought by the Commission against respondents, with the exception of the cases described in the preceding paragraph, 15 to 30 days are ordinarily allowed, and reasonable requests for continuances are liberally granted.

The Commission's general rules do not fix the situs of hearings, but the place is set in the notice. The place of hearing varies with the different types of cases; in contrast to hearings held by the National Labor Relations Board, for example, there is no usual policy of holding hearings at the site of the conduct or transaction which is involved, or at or near the respondent's place of business. Thus, although a few are held in the field, stop order hearings under Section 8(d) of the Securities Act are usually held in Washington, partly because the necessary data are kept in the Commission's files in Washington, and the Washington staff which has examined the registration statement has the most intimate knowledge of the issues, and partly because it would entail a burdensome expense to the Commission to send its counsel and experts, who often must testify in proceedings of this nature and who are attached to the Washington

office, to the field. Although this policy would appear to place a heavy burden upon the registrant, it is urged that the burden is more apparent than real since the Commission usually subpoenas him and thus pays his expenses, and, similarly, most of the persons whom he would call as witnesses - the accountant, the underwriter, and others who participated in the preparation of the statement - are also called as witnesses by the Commission. <sup>132</sup> Further, it is suggested that, in fact, the registrant usually prefers to have the hearing held as far away from the scene of his business as possible, since the chances of unfavorable publicity and consequent damage to his dealing in the security involved are likely to be diminished.

In contrast, cases involving the revocation or denial of broker-dealer registrations are invariably held in the field at a point convenient to the respondent. This policy is said to have been followed because availability of data in Washington is not usually of major consequence, while, on the other hand, the respondents are likely to be individuals of limited resources, who,

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132. It would seem that, under these circumstances, it is almost as expensive for the Commission to hold the hearings in Washington as in the field.

in addition, frequently call local people as witnesses. In respect of applications for extension of unlisted trading privileges, the hearing on the first such application by each exchange is held in Washington, because a complete record of the mechanics of such exchange must be made, and the unlisted securities unit in Washington is more familiar with this technical subject than the field staff. Once the picture has been recorded, however, hearings on subsequent applications are held at the site of the applicant exchange, except that applications by the New York Curb Exchange are heard, at its own request, in Washington.

Two cases serve to illustrate other general policies which the Commission follows in fixing the site of the hearings. In In the Matter of Michel Meenan, 1 SEC 238 (1935), the respondent was alleged to have engaged in manipulative transactions on the New York Curb Exchange. Hearing was ordered to be held in Washington; but respondent's counsel moved for a change of venue to New York City. The motion was stated to have been based on respondent's desire "to have the locus of the hearing in closer proximity to the witnesses." The Commission denied the motion and observed that it had originally designated Washington as the place

of hearing "on the theory that this case, being of importance in that it was one of the first cases to be brought under this provision of the statute, should be subject to the Commission's own close supervision at all stages . . . In an initial proceeding under this section, motions may be made during the course of the taking of testimony whose determination will have to be made by the Commission itself rather than by the trial examiner."

A different result was reached in a subsequent manipulation case: In the Matter of Charles C. Wright, 1 SEC 560 (1936), involved transactions on the Los Angeles Stock Exchange. After counsel for the respondent had insisted upon strict proof of such transactions, counsel for the Commission moved to continue hearings from Washington to Los Angeles. The Commission overruled respondent's objections to this motion, stating that in order to obtain evidence of the transactions on the Los Angeles Exchange, "it is necessary to examine witnesses and to obtain testimony verifying the original records of some 200 brokerage houses, the greater part of which are in Los Angeles, in order that strict proof may be obtained of the entries in these records as to the transactions in question." The Commission held that to require the

brokerage houses to send their books and records to Washington and to send members of the office staff to verify such records would "constitute an unwarranted hardship upon such firms." In addition, the Commission pointed to the probable necessity of obtaining further and additional records, as testimony developed; accordingly "The consequent additional delay and expense would seem to make it inadvisable to continue the proceedings in Washington."

Commission hearings are customarily held at its own offices in Washington or in the field, in rooms designated for hearing. Commonly, hearings are public. Section 21 of the '33 Act requires that "All hearings shall be public"; Section 22 of the '34 Act and Section 19 of the Holding Company Act provide that hearings may be public; while Rule V(b) of the Commission's Rules of Practice prescribes that all hearings except those upon applications for confidential treatment<sup>133</sup> "shall

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133. Since the exception applies also to confidential cases under the '33 Act, the Commission has perforce had to depart from the requirement of that Act that "All hearings shall be public". It has been held that before such applications may be denied, the Commission must hold a hearing and that Congress so intended. American Sumatra Tobacco Co. v. Securities and Exchange Commission, 93 F. (2d) 236 (App. D. C. 1937) (application under (Continued)



be public unless otherwise ordered by the Commission." While in the early history of the Holding Company Act private hearings were occasionally ordered by the Commission, none has been held, except in cases involving applications for confidential treatment, in the past few years.

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133. (Cont'd.) the '34 Act). Yet if the Commission were to follow this decision and the mandate of the '33 Act that all hearings be public, the entire purpose of a provision for confidential treatment would be defeated. Accordingly, either the judicial or the legislative mandate had to give way; the Commission modified the latter.

134. When private hearings were held, it was at the request, and for the benefit, of persons outside the Commission. But compare In the Matter of Utilities Employees Securities Co., et al, 3 SEC. 1087 (1938), where in a hearing under Sections 2 (a) (8) (declaration as a subsidiary) and 2 (a) (11) (D) (declaration as an affiliate) of the Holding Company Act, the companies filed a motion for confidential treatment of information and data adduced in the hearing and that the hearing be discontinued unless private and confidential. Petitioners' motion was grounded on the claim that the hearings would result in the disclosure to its competitors, other investment companies, and the public of its "established policies for the investment of its funds and the particulars and details of its business operations involved in carrying out these policies including the nature of the securities in which the petitioner is interested in investing, the prices which it has in the past and presumably will in the future be willing to pay therefor, the nature of the securities it may be interested in selling . . . , the brokers, organizations and persons through whom it carries out its transactions, and other details of its business and operations of a highly confidential nature and substantially constituting its trade secrets and processes in carrying out and completing its established investment policies." The Commission

(Continued)

The conduct of hearings: trial examiners.

Pursuant to Section 21 of the '33 Act, Section 22 of the '34 Act, Section 19 of the Holding Company Act, and Rule V(b) of the Commission's Rules of Practice, hearings for the purpose of taking evidence are, with a few exceptions, <sup>135</sup> held before

134. (Cont'd.) denied the motion; it pointed out that investment methods were not "trade secrets or processes", that a major abuse leading to the Act was lack of adequate information, that the proceedings are "more than mere contests between private litigants . . . they are inquiries in which the states and the nation itself have an interest in seeing that justice is done." With considerable indignation and some glee, mindful of the charges of star chamber proceedings, and citing Jeremy Bentham and the criticism of the majority of the Court in Jones v. Securities and Exchange Commission, 298 U. S. 1, 28 (1936), the Commission's opinion concluded:

"Nor is it irrelevant here to refer to the deep-rooted common-law tradition of public trials and hearings - a tradition justified and defended as a precaution against abuse in administration of justice . . . We recall, too, that closed hearings were also among those 'intolerable abuses of the Star Chamber, which brought that institution to an end at the hands of the Long Parliament in 1640' . . . Private hearings should be the exception rather than the rule."

135. In In the Matter of Edison Electric Illuminating Company of Boston, 1 SEC 909 (1936) (application to extend unlisted trading privileges), a trial examiner presided but a majority of the commissioners was also present; In the Matter of Charles True Adams, 3 SEC 390 (1933) (application for fees in a utility reorganization) was held before a single commissioner and a trial examiner; and In the Matter of Charles C. Wilson, 1 SEC 402 (1936) (revocation of a broker-dealer registration)

(Continued)

trial examiners designated by the Commission.

Unlike the administrative arrangement common to other agencies, there is no Chief Trial Examiner devoting his full time to supervising the staff of examiners, but rather one of the commissioners is designated as their Sponsor and Chief Trial Examiner - a task to which, in view of his other duties, it is unlikely that he can devote a great deal of time. The trial examiners are administratively an independent unit, responsible only to the Commission itself and in no way responsible to the General Counsel's office or other divisions.

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135. (Cont'd). was held, in part, before a commissioner. All these were cases of novel impression.

136. One observer has commented that "The use of trial examiners in anti-manipulative cases . . . is open to question. The Commission has justified this course of conduct by reference to the approval which courts have given to similar practices under other administrative statutes, and also to the use in ordinary court proceedings of special masters and referees. There is much to be said in favor of the flexibility permitted by this procedure. When employed to collect statistical or other non-controversial evidence, it is not open to serious question. The use of trial examiners in proceedings of a criminal nature, which necessarily involve sharp conflicts of testimony and the credibility of witnesses is a different question. It is difficult to see how the Commission can fairly pass upon the guilt or innocence of a respondent without having seen the witnesses and heard them testify." Redmond, op. cit. supra, note 19, p. 640. The legal propriety of utilizing examiners in this type of case now seems to be moot, nor is any alternative method readily apparent.

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At present the Commission's regular staff of trial examiners totals 11 in number; in addition, during the summer months, three or four additional examiners are recruited temporarily from the interpretative section of the Legal Division. In one case of considerable complexity, the Commission appointed a trial examiner - Assistant Attorney General (then Professor) Thurman Arnold - from outside the Commission altogether, while until fairly recently, attorneys in the General Counsel's office were sometimes designated to preside over difficult hearings.<sup>137</sup>

In respect of the regular staff of 11 examiners, none is engaged in litigation, whether administrative or otherwise; only one, by special direction of the Commission, is permitted to engage in interpretative work for a regional office when his time permits.

Each of the 11 regular examiners is a lawyer - a qualification which while perhaps useful in ruling on questions of evidence seems scarcely

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136. (Cont'd.) But, indeed, issues of credibility should ordinarily be left to the examiner. See infra, pp. 232-234.

137. "Both of these devices [recruitment of examiners from the outside and from the General Counsel's staff] had their virtues, but at the same time, failed to promote the building of a permanent force." Landis, op.cit. supra, note 8, p. 105.

the exclusive qualification for competence in treating the technical questions of accounting and financial analysis which often arise in Commission proceedings. Nevertheless one of the examiners is a certified public accountant, some examiners have made special studies in accounting fields and all have acquired some experience in these fields, and all have acquired some experience in these fields in the course of their work at the Commission. Two of the examiners have had experience as judges; another served as a master in chancery; and two others had previously acted as trial examiners for other administrative agencies. Eight of the eleven examiners were formerly in private practice; one was a member of the staff of the Solicitor General's office; and one was on the staff of the Commission's Registration Division. The examiners are not subject to civil service; under the classification act, however, the examiners fall into the P-5 (\$4,600 to \$5,400 annually) group - a limitation which according to a former chairman of the Commission, renders it "impossible to expect . . . those qualities which are necessary to make a good trial examiner - experience in the disposition of business and wide knowledge of the field of regulatory activity."<sup>138</sup>

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138. Id., p. 104. Although insufficient data and  
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In general, examiners are assigned to particular cases according to their availability in respect of geographical location and work-load. Some of the examiners are attached to regional offices; accordingly, they will be assigned to hearings held in their region wherever possible. In addition, selection of examiners for particular hearings is based partly upon their ability and experience with reference to the type of case heard; nevertheless, it is stated that most of the staff of examiners at present are qualified to hear "practically any of the Commission's variety of proceedings." The office of the Sponsor or Chief Trial Examiner controls the trial examiners' calendars; the Commission itself at least in form designates the examiner for the particular hearing. Such designation is made at the time of, and in, the notice of hearing. The examiner's knowledge of the particular case prior to the hearing is

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138. (Cont'd.) opportunity for first-hand observation make an independent conclusion impossible, one cannot avoid being impressed with the persistent criticism, by persons both within and without the Commission, of the ability of the trial examiners - a phenomenon not peculiar to the SEC. Lack of confidence in its examiners may account for the Commission's restrictions upon the trial examiners' powers (infra, pp.183-190) and its failure to give their reports any considerable weight (infra, p.240 ).

limited to the pleadings and other formal papers; in cases under the Holding Company Act he may, however, examine the Commission's public files if time permits.

On one or two occasions there has been substitution of trial examiners in the course of the proceeding owing to "the exigencies of personnel and administration". In such a situation, the second examiner considers all the evidence taken by his predecessor and signs the report; in addition, the first examiner may also sign the report, with a statement that he concurs in it so far as the facts were presented before him. The Commission has rejected the contention that such a substitution deprives respondent of due process of law in that the findings are not made by one official who has himself heard the evidence; in its opinion, the Commission held that neither the statute nor due process requires the taking of evidence by a single officer, nor is the respondent prejudiced by such substitution since the Commission in any event considers the evidence, briefs, and oral argument.

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139. In the Matter of Kinner Airplane and Motor Corp., Ltd., 2 SEC 943 (1937); cf. In the Matter of Charles C. Willson, 1 SEC 402 (1936). No examiner  
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Powers and functions of the trial examiner;  
interlocutory appeals. In general, at a Commission hearing the trial examiner is a presiding officer whose major function is to keep the proceedings in progress and preserve order. As stated in a memorandum (October 26, 1936) from Commissioner Nealy, as Acting Chief Trial Examiner, to the examiners:

"The Trial Examiner as the presiding officer has authority over the deportment of those in the hearing room. It is his duty to rule on the admissibility of evidence, to control the contents of the record, to limit argument, and to control similar matters of procedure."

The examiner is in no sense an advocate; the active presentation and conduct of their respective cases are, in the main, left to counsel. Although Rule V (c) of the Commission's Rules of Practice empowers the examiner to "call for the production of further evidence upon any issue," officials can recall no case in which he has actually called new witnesses. Frequently, however, examiners supplement the record by questioning witnesses on points

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139. (Cont'd.) has yet been disqualified for bias; in a recent hearing in which decision is still pending, however, respondent four times moved for a "mistrial" on the ground of bias and prejudicial statements. The motions were denied by the examiner.



which they deem necessary for clarification; the extent to which they engage in such questioning varies, of course, with the individual examiners. Such questioning is commonly reserved until counsel have completed their inquiry in respect of the particular subject-matter.

In the main the examiner is completely independent in his conduct of the hearing, perhaps because, as noted immediately below, his powers are severely restricted. He is under strict instructions to avoid conferring concerning the issues with Commission counsel or others participating in the case. He is, however, free to, and sometimes does, communicate with the Commission itself, with technical experts such as accountants or engineers or with attorneys in the interpretative section of the General Counsel's office in Washington who have no connection with the case before him.

Rule VI(a) of the Rules of Practice limits the examiner's powers at the hearings: "Motions in any proceeding before a trial examiner which relate to the introduction or striking of evidence, or motions before a trial examiner in any proceeding pursuant to Section 8 of the Securities Act of 1933,

as amended, which relate to amendment of the notice of hearing to include additional items of the registration statement <sup>140</sup>... may be ruled on by the trial <sup>85</sup>examiner. All other motions shall be ruled on by the Commission." In addition, the examiner may rule on contested motions for postponement, continuance, and time and place of hearings; where such motions are difficult or of any considerable consequence, however, he may either informally consult the Commission thereon, or may formally refer the <sup>141</sup>motion to the Commission. Motions to amend in

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140. Even the power to rule on motions to amend notices under Section 8 is one which the examiners have only recently acquired; formerly, examiners were required to transmit such motions to the Commission. Cf. In the Matter of Metropolitan Personal Loan Co., 2 SEC 803 (1937). The reason for permitting the examiner to rule on motions to amend in Section 8 proceedings only, and not others, is stated to be that Section 8 orders specify certain named items so that the field is a narrow one, while in cases involving the revocation of a broker-dealer registration or manipulation, the field may be broader, involving questions of violation of the several Acts, raising issues of policies, and possibly changing the entire theory of the action. Even motions to amend in Section 8 proceedings are still passed on by the Commission if made before the hearing.

141. E.g., In the Matter of Michael S. Heehan, 1 SEC 238 (1935); In the Matter of Charles C. Wright, 1 SEC 560 (1936) (motions to change place of hearing passed on directly by the Commission); In the Matter of Utilities Employees Securities Company, et al; 3 SEC 962 (motion to separate consolidated hearings).

cases other than those arising under Section 8 of  
the '33 Act; motions to dismiss in whole <sup>142</sup> or in  
part; motions to intervene or participate; motions  
to separate or consolidate must all be reserved for  
determination by the Commission.

Rule VI (b) of the Rules of Practice pre-  
scribes the procedure for motions or similar plead-  
ings calling for determination by the Commission.  
If made before the hearing, they must be filed in <sup>143</sup>  
writing with the Commission Secretary in Washington;  
if filed during the hearing, they may (but are not  
required to) be transmitted to the trial examiner,

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142. The Commission will not in any event pass  
upon motions to dismiss, either on the merits or  
on the jurisdiction, until the close of the entire  
case. "To entertain a motion of this character  
at this stage [at the conclusion of the Commission's  
presentation of its case] would merely make for  
delay. To permit appropriate determination of the  
motion by the Commission would require the trial  
examiner to make intermediate findings of fact to  
which, of course [parties]... would be entitled to  
file exceptions and briefs. The only alternative  
would be for the Commission itself to examine the  
entire record, thus displacing the trial examiner  
and departing from the accustomed mode of proceed-  
ure. This would make for such piece-meal presen-  
tation of the case that long delay would be un-  
avoidable." In the Matter of Charles C. Wright,  
1 SEC 901, 944 (1936); cf. In the Matter of  
American Credit Corp., 1 SEC 230 (1935) (submis-  
sion of stipulation agreeing to modify registration  
statement in accordance with show cause order held  
motion to dismiss upon which examiner could not rule).

143. Motions may be denied for prolixity. See In  
the Matter of Gerald M. Loeb et. al., 3 SEC 358 (1936).

who must refer them to the Commission. The motion must be accompanied by a written brief; reply briefs may be filed within five days after service of the motion. Decision on the motion will be upon the basis of the briefs unless otherwise ordered by the Commission; under the rule, no oral argument will be heard unless the Commission so directs. In fact, it is stated, oral argument will be permitted on the motion if the Commission has doubts about granting it. The examiner does not, in any event, play any part in the disposition of the motion and makes no recommendations; determination is by the Commission or, in the case of difficult questions, by the Commission with the assistance of the interpretative section of the General Counsel's office, which prepares an analysis, recommendations, and occasionally a formal written opinion. Finally, it is to be noted that even on motions upon which the examiner does have power to rule - issues of evidence or continuance, for example - it is possible, although the rules do not so provide, to take interlocutory appeals to the Commission from the examiner's ruling. Such appeals are rare, and the Commission frowns upon them; in one recent case, however, counsel for the Commission took four appeals from evidentiary rulings in the course of a

single hearing.

It is insisted that the cumbersome arrangements and the burden upon the parties and the Commission involved in the Commission's formal participation in the intermediate phases of a hearing are, in fact, less serious than they might appear. Often, for all practical purposes the examiner will dispose of the motion himself by reserving decision thereon for determination by the Commission only at the conclusion of the entire case; motions to intervene or participate are ordinarily handled in this manner and, by such reservation, full participation is permitted. Further, the closely contested cases in which motions which must be passed upon by the Commission are most likely to arise are usually held in Washington, (cf., the Meehan case, supra, p.173 ), so that the situation which would necessitate stopping the hearing to travel to Washington for oral argument is made comparatively rare; moreover, parties in the field may argue before the examiner and their recorded argument will be immediately transmitted to the Commission. Finally, there is some evidence that the Commission's rules are in some instances which are not apparently typical honored more in the breach than in the observance: One examiner states he has never been bothered by the limitations, that in the course of

two years, he has ruled on all motions coming before him, and that he is in complete control of the hearing.

Whether the withholding of power from the trial examiner is a phenomenon which obtains only in the Commission's rules or extends to the stage of actual practice, the comments included in a prior monograph prepared by this Committee's staff in respect of a similar situation seem equally  
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applicable here:

"The withholding of power from the trial examiner necessarily infects the trial proceedings with a certain measure of indecisiveness and exposes them to the threat of constant interruption...During the very progress of a hearing...a case may in effect be withdrawn from the trial examiner and remitted to the Commission for consideration at an intermediate point. The wisdom of the Commission's intrusion into the hearing at this stage is open to the most serious doubt. In the long history of the administration of justice there is persuasive evidence that, taken as a whole, time and expense are saved to the parties, to the trial courts and to the appellate courts, by requiring that the trial stage be completed before appeals are allowed. While it is obvious that cases will arise from time to time in which the trial examiner's ruling... may be of such critical importance that error would require a complete repetition of the proceedings, yet it

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144. The Federal Trade Commission, Monograph No. 6, pp. 40-41.

is questionable whether interruption of many hearings is not too high a price to pay for securing prompt reversal of the occasional error of a grave nature. And there is a clear measure of inefficiency in having the Commission familiarize itself with a case at several stages, as is necessary if it is itself to rule wisely on questions relating to the relevancy of proffered proofs." 145

Participation of Commission counsel in

the hearings. In all decisive hearings held by the Commission, the latter is represented not only by a trial examiner, but by one or more Commission counsel. Such counsel, however, primarily represents not the Commission but the particular division or unit in whose jurisdiction the subject-matter lies - a distinction which the Commission's final opinion is careful to preserve through its reference to "counsel for the Registration Division" or "counsel for the Over-the-Counter Unit." As a rule, this counsel (herein called the Commission counsel for purposes of convenience) is attached to the division which instituted the proceeding and is the same one who participated in the earlier phases of

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145. In one case, four different formal opinions were issued by the Commission on four different motions made in the course of the hearing, or just prior thereto. That the Commission itself is aware of the considerations set out above, and the disadvantages inherent therein, is indicated by its language in the Wright case, set out supra, note 142.

investigation, drafting of the show cause order, negotiations, and the like. In the great majority of cases involving the withdrawal of listed securities, however, the hearings are held in the field and an attorney attached to the staff of a regional office rather than a member of the unlisted securities unit acts as Commission counsel. Similarly, because the '34 registration unit has only two attorneys, the Commission counsel in cases involving delisting under Section 19(a)(2) of the '34 Act is usually assigned from the '33 registration unit. Further, in some particularly important or difficult cases, an attorney from the General Counsel's office may act as Commission counsel; in such cases, however, so strict are the policies of separation, the ultimate opinion will not be drafted by the interpretative section of the General Counsel's office.

The nature as well as the extent of the participation of Commission counsel varies according to the type of case involved. In proceedings brought by the Commission against a respondent, the staff attorney is an advocate in the fullest sense of the word; he is not permitted to assist respondents



and his function is to prove his case. The Commission proceeds, in such cases, upon the theory that the public interest requires a vigorous prosecutor to present the whole case against the respondent; assistance to the respondent in clarifying points is left to the trial examiner, and the question of leniency is left to the Commission itself after the issues have been tried.

On the other hand, in most cases involving hearings on applications, such as those for the withdrawal of a security listed on an exchange, or extension or termination of unlisted trading privileges, and the normal case under the Holding Company Act, the staff attorney presents no affirmative case, does not act as advocate, but is simply present to assure that the evidence is sufficient and properly presented so that the Commission can make its ultimate decision upon the record. In this type of case, the Commission's instructions (Memorandum from Commissioner Healy to trial examiners, October 26, 1936) are that "Every applicant should present his own case before the Trial Examiner. Commission's counsel is not precluded from offering suggestions or evidence on points which have not been covered." In cases of this nature, the underlying consideration is that the proceeding involves a

"thorough inquiry into the pertinent facts but not violations or non-compliance with the law;" accordingly, "the public interest demands that the applicant's case be presented just as fully as possible, and there is no impropriety in allowing Commission's counsel to complete the record if the applicant has failed to do so."<sup>146</sup>

But it is to be noted that no sharp line can be drawn between the first type of cases - proceedings against a respondent - and the second - proceedings upon applications. For example, in hearings on applications for withdrawal of listed securities, Commission counsel may begin to suspect that the applicant is attempting to evade his obli-

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146. "For [the administrative] process to be successful in a particular field, it is imperative that controversies be decided as 'rightly' as possible, independently of the formal record the parties themselves produce. The ultimate test of the administrative is the policy that it formulates; not the fairness as between the parties of the disposition of a controversy on a record of their own making. In securities regulation, for example, the two problems of the admission of securities to unlisted trading and the striking of securities both from listed and unlisted trading, are pertinently significant. Here it soon becomes obvious that to determine these matters purely upon the record as the parties made it, would lead to results governed more by chance than by the application of a consistent policy. The Commission itself is theoretically not a party to the proceedings. Ordinarily, the contest as it arises poses an issue between management and an exchange, or a trading interest,

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gations to security holders; Commission's counsel's questioning may then become "prosecutory." Similarly, in proceedings on applications and declarations under the Holding Company Act, the Utilities Division may, prior to the hearing, take a position adverse to the applicant or declarant; its counsel will, accordingly function completely as an advocate with a "case" to make; or, even where the staff takes no such adverse position, the counsel's questioning may be a vigorous exploration in the nature of cross-examination so as to present the full picture.

Nevertheless, in the ordinary hearing upon applications, where the staff has not in advance taken an adverse position, the role of the staff attorney is simply to assist the parties and explore the issues. In many hearings upon applications under the Holding Company Act, there may be little or no examination; in cases involving withdrawal from listing or extension or termination of unlisted trading privileges, if there is a contest at all, it is likely to be between outside

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146. (Cont'd.) as advanced by a dealer in the over-the-counter market. The Commission's staff, however, has usually assumed the burden of exploring the facts and counseling the parties with reference to the nature of the issues that may be involved." Landis, op. cit. supra, note 8, pp. 39-40.

parties (see supra, note 146). Since a very large number of the hearings held by the Commission are "uncontested" in these respects, the query arises why there should be a need at such proceedings for both a trial examiner and a Commission counsel. If the case is of the type where the Commission is acting chiefly as an umpire, or if its role is simply to clarify and complete the record, the function of the examiner and of the counsel would seem to overlap. Indeed, it is conceded that in the great majority of such cases, there is no need for the two officers, but the practice is defended on the ground that it is impossible to predict in advance what the course of the proceeding will be, and if in fact there is only a single staff member acting as examiner and the occasion arises for vigorous cross-examination, it would not be suitable for the examiner to perform this function. Further it is suggested that at least in listing cases, the issues are technical and the trial examiner would have insufficient time to prepare for each case; accordingly, a staff counsel is, as a practical matter, desirable to assist the examiner. Yet these reasons are not wholly persuasive. In Holding Company Act cases, the Utilities Division staff has a good idea in advance of what the developments will

be, and whether there will be need for "prosecution," even if it takes no formal pre-hearing position; in listing cases, "prosecution" occurs very rarely, and again, prediction is possible. And even if an exceptional case does occur where vigorous cross-examination is unexpectedly found to be necessary, it does not seem impossible for a trial examiner to conduct such exploration without acting wholly as a partisan. Nor, finally, does the objection of the examiner's lack of time to prepare, or his lack of expertness in the premises, seem to be insuperable. Since, by their very nature, these are not cases where the Commission or its staff has a case or point to present, administrative separation, as is recognized in the post-hearing procedure (infra, pp.250-254), is not necessary. Accordingly, the member of the Utilities Division, or the unlisted securities unit, as the case may be, who studied the application, who is most expert in the issues, and who would otherwise have acted as counsel, would seem to be entirely suitable as an examiner. Under such an arrangement, thus, the regular examiners would be left free to devote more time to contested cases while, at the same time, these other hearings would be conducted by experts who are in a peculiarly suitable position to clarify

and complete the record when clarification and  
completion become necessary.

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The record of the proceedings. Each of the three Acts expressly requires that appropriate records of Commission hearings shall be kept; in addition, Rule V (c) of the Rules of Practice provides that "Hearings for the purpose of taking evidence shall be stenographically reported and a transcript thereof shall be made which shall be a part of the record of the proceeding. Transcripts of public hearings will be supplied by the official reporter at the prescribed rates."

With some exceptions (chiefly in manipulation and a handful of Holding Company Act cases), Commission records are rather short; in the main, the Commission, through and with the cooperation of counsel for outside parties, has made effective use of devices to contract the record. Stipulations in respect of facts or of entire issues, even in cases brought by the Commission against respon-

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147. The combination of the functions of examiner and agency counsel is not without precedent in licensing procedure. Cf. this Committee's Monograph No. 3, Federal Communications Commission, p. 44. The F.C.C., it is to be noted, may have a single staff member even where it contemplates denial of a license; its hearings are, in fact, ordinarily reserved for cases of contemplated denial.

dents, are frequently utilized; in addition, parties may stipulate records of related proceedings into the record of the decisive proceedings. Thus the record of a formal Section 8 (c) investigation may be stipulated into the record of the Section 8 (d) proceeding, and, as has happened, may constitute the entire record; similarly, the record of an investigation under Section 21 (a) of the Exchange Act has been stipulated into the record of the subsequent decisive proceeding involving a question of manipulation. Stipulation of records in connected proceedings is frequent in unlisted trading privileges cases while parties may also stipulate into the record authoritative works in the place of expert testimony.

Another method of shortening the record and the proceedings is the consolidation of hearings under Rule XVIII of the Rules of Practice, which provides that "By order of the Commission, or upon agreement between the parties and counsel to the Commission, proceedings involving a common question of law or fact may be joined for hearing of any or all matters in issue in such proceedings, and such proceedings may be consolidated, and the Commission may make such orders concerning the conduct of such proceedings as may tend to avoid un-

necessary costs or delay." Consolidation is frequently ordered by the Commission, particularly in cases arising under the Holding Company Act. 148

To avoid lengthening the record, Rule V (d) of the Rules of Practice provides that the transcript shall not include argument or debate on objections to the admission or exclusion of evidence, except as ordered by the Commission or the

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148 Thus, In the Matter of Utilities Employees Securities Company, et al., 5 SEC 926 (1938), UESCO filed an application for an order by the Commission declaring that it and its subsidiary were subsidiaries of certain specified companies under Section 2 (a) (8); at the same time, the Commission, upon its own motion, ordered a hearing to determine whether UESCO and its subsidiary were affiliates of such specified and other companies under Section 2 (a) (11) (D). The Commission ordered the hearings consolidated. Thereafter UESCO filed a motion to separate on the ground that evidence was being introduced at the consolidated hearings which was pertinent to determine whether it and its subsidiary were affiliates, but was prejudicial to the determination of UESCO's application under Section 2 (a) (8). The Commission denied the motion, holding that the issue of control involved in 2 (a) (8) proceedings is closely related to affiliation under 2 (a) (11) (D). In both matters, the Commission observed, the relationship of UESCO to certain other companies, four of which were common to both proceedings, was pertinent, so that with respect to such companies, "evidence which was properly admissible on the question of control would seem to be pertinent to the question of affiliation, and insofar as evidence properly admissible and dealing particularly with affiliation is concerned, it would in large degree be pertinent to whether a 'controlling influence' existed or was being exercised within the meaning of Section 2 (a) (8)." In order to "avoid any possibility of confusion of the issue  
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trial examiner. Although this would in general seem to be a sensible rule to avoid encumbering the record with extensive discussion by counsel, the practice of trial examiners with respect to it varies: Some always include the argument, some always exclude it, and some exclude it only if it threatens to be protracted and, in that case, will summarize the arguments at their conclusion for the record.

As has been described above (pp. 102-104), the Commission has been extraordinarily successful in diminishing the record of many cases, especially under the Holding Company Act, almost to the vanishing point by means of pre-hearing conferences whereby almost all facts are agreed upon and the issues are greatly narrowed. Such conferences continue informally in the course of the hearing; it is not uncommon for counsel for the Commission and other counsel to call a recess during a hearing,

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148. (Cont'd.) in the two cases," however, the Commission provided that counsel would be permitted to brief and argue the two proceedings separately "in order to point out to us how they believe the evidence in the record applies to one of the proceedings and not to the other."

confer over the method of procedure, and return shortly with an agreement on the best method of producing evidence or otherwise presenting the issues with a minimum of waste motion and a maximum of expedition.

Finally, it is to be noted that provision is made to permit cases to be determined on a record which consists solely of the application: Rule U - 3 (d), relating to applications and declarations under the Holding Company Act, and Rule X - 12D2 - 1 (b) (3), relating to applications to withdraw a security from listing under Section 12 (d) of the Exchange Act, both provide that the application (which must be verified) may state that the applicant offers it in evidence at any hearing thereon. If such offer is made, the application is received in evidence at the hearing as proof in support of the allegations therein without the necessity of the applicant's appearing and introducing further evidence, unless there is objection by Commission counsel or other interested party. If Commission counsel intends to object, or if he learns in advance of the hearing date that an interested person intends to object, he must promptly advise the applicant thereof. If the objection is made too late for seasonable notice

to the applicant, the hearing will be continued to permit him to appear, but if he fails to appear after notice of objections, the application will be dismissed. Especially under the Holding Company Act in cases where the Utilities Division is satisfied that the proposed transaction complies with the statutory standards, the useful procedure afforded by this rule is utilized and the record is confined simply to the application.

The process of proof. In general, the order of presentation in Commission proceedings is, in cases brought by the Commission against a respondent, for the Commission first to produce its case and the respondent to follow. In cases begun by application, and in most Holding Company Act cases, even where the Commission's staff takes a position adverse to the application or declaration, the case is opened with the presentation of the applicant's case and the Commission commonly calls none of its own witnesses or presents an affirmative case. In a few proceedings under the Holding Company Act, however (for example, those involving an absence of arm's length bargaining which would render an underwriter ineligible to receive a fee, or involving the existence of such control as to subject a company to a declaration that it is a subsidiary or a holding company), the Commission's staff may adduce an affirmative case.

In respect of the general rules of evidence, the Commission's policy has been described in a number of ways: In a memorandum, Commissioner Healy, Acting Chief Trial Examiner, instructed the examiners (Oct. 26, 1936) that "A liberal policy should be followed in receiving evidence. The substance and reason at the base of the common law rules of evidence should be honored, but technical rules should not be too closely followed. Nevertheless, the

proof should be reliable and authentic. Care should be taken to restrict findings to those points upon which the record contains substantial authentic evidence."

In somewhat similar vein, the Commission's General

Counsel has commented (Address before the Legal Club of Chicago, March 20, 1959):

"... The only really important question of evidence presented to a competent trier of facts is whether the line of questioning is so far beyond the scope of inquiry that it is a waste of everybody's time to pursue it further. If it is not clearly out of bounds, let it in, whatever its form, and let the trier of facts evaluate it when he has the whole picture before him."

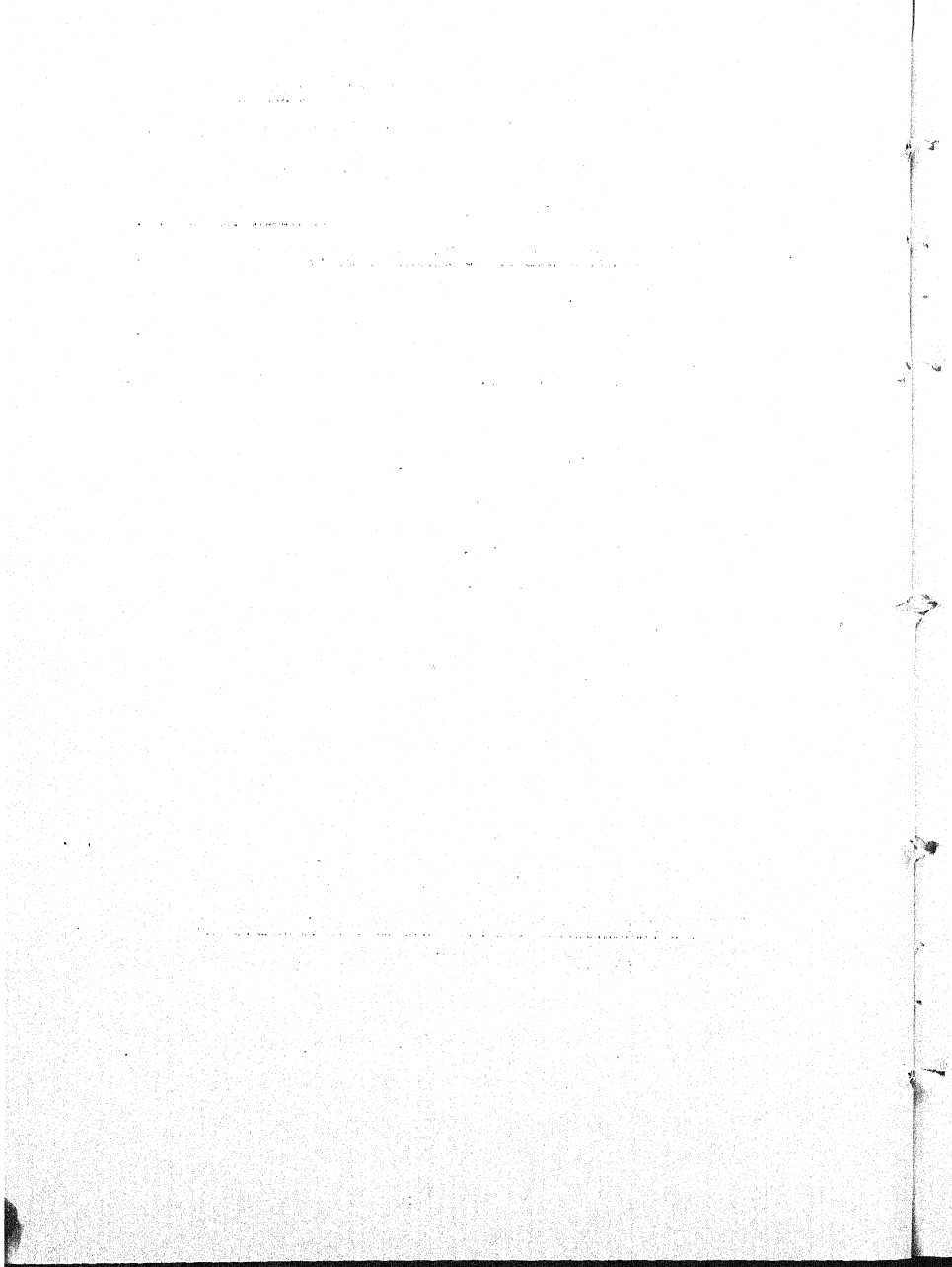
Finally, a Commission trial examiner has stated that while he follows the technical rules of evidence as closely as possible, he will not permit such rules to be invoked to exclude any evidence which would have some probative value; unless there is a question of privilege involved, the touchstone is relevancy.

In some respects there is adherence to the strict legal rules of evidence.<sup>149</sup> Privileged communications are respected as in judicial proceedings; opinions of experts are received only after the usual examination into their qualifications. Hearsay is

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149. Objections to admission of evidence are frequent in proceedings brought upon the Commission's own motion, and rare in other types of cases. Objections must be in short form, stating the grounds of objection relied upon. Exceptions must be taken to adverse rulings—a requirement which seems to be unnecessary, but which is said to be useful, since objections are quite frequently abandoned.

not considered to be untrustworthy per se; if uncorroborated and believed to be untrustworthy, however, it will be either excluded or, if admitted, will not be considered. Thus in In the Matter of American Terminals and Transit Co., 1 S.E.C. 701, 729-730 (1936), one of the issues in the stop order proceedings was the precise nature of registrant's coal. Both the Commission and the registrant submitted laboratory reports analyzing coal samples and conflicting with each other. Both counsel objected to the reports submitted by the other on the ground that they were hearsay. The Commission held that the trial examiner properly overruled the objections, and stated that it was "disposed to ignore the whole question of hearsay as technical, and to consider both exhibits for the purpose of broadening the base of the evidence on this crucial point. It will be noted that should they both be excluded from consideration, the weight of the remaining evidence on this issue. . . is against the registrant." On the other hand, in In the Matter of Queensboro Gold Mines, Ltd., 2 S.E.C. 860, 864 (1937), one of the issues was whether registrant had accurately stated that its stock was actively traded in on the over-the-counter market. The trial examiner found the statement to be false; the only evidence supporting his finding was a letter,



introduced by the Commission counsel, written by the mining editor of a newspaper stating that "from what I can gather" and "one trader informed me that" there is no trading activity in the stock in question. Even though no objection had been made to the admission of the letter, the Commission reversed the examiner's finding, stating "while this is clearly hearsay yet we have held hearsay evidence to be admissible and an objection to it technical in the absence of an attack on its accuracy. . . . Nevertheless, and despite registrant's failure. . . . to attack its truth, and although we regard it as evidence, it does not afford a satisfactory basis for a finding of fact."

Conclusions and inferences on the part of lay witnesses are excluded or disregarded. In In the Matter of Charles C. Wright, 3 S.E.C. 190, 214 (1938), such testimony was admitted, but the Commission stated "We have. . . . disregarded all of the testimony referred to in respondent's brief as 'conclusions', 'reasons', 'understandings', and 'rumors'. Thus we have given no weight to Porter's 'understandings' as to persons with whom he was dealing. . . . Similarly we have disregarded Weikel's 'conclusions' as to the nature of the distribution to be made of the. . . stock and his 'idea' as to why Stern was to discuss the option with Roy Bayly."



The best evidence rule may or may not be observed according to the nature of the case. Ordinarily, proof that a copy is a true copy of an original document will be considered a satisfactory foundation for accepting the copy, if the proof appears trustworthy, even in the absence of strict proof of the loss or destruction of the original; however, oral evidence of the contents of a writing will be rejected unless there is a showing that such writing and all copies have been lost or destroyed or are otherwise unavailable. In cases involving applications for unlisted trading privileges, the applicant exchange must establish the existence, in the vicinity of such exchange, of sufficient public trading activity. Such trading will normally have been carried on by members of the exchange through the facilities of a primary exchange on which the security is listed; the only source of original evidence of such trading would be the books and records of members of the applicant exchange. Yet the burden of producing these books and records is deemed to be too great, and accordingly it is customary for the Commission to accept a summary prepared by the secretary of the applicant exchange on the basis of data supplied by the exchange's members. But in a different type of proceeding, stricter proof may be insisted upon: For

example, in a case brought by the Commission to expel a member from an exchange for violation of the prohibitions against manipulation, the Commission has held that the respondent has a right to insist upon strict proof of trading, and, if he does so, the original books of the brokerage houses must be produced and verified. 150/

All witnesses in Commission proceedings are required to be under oath, and all testimony is subject to cross-examination. In particular types of cases, ex parte statements and affidavits may be admissible. As already described, some cases may be disposed of entirely upon the basis of a verified application. In addition, in cases involving applications for withdrawal of listed securities, letters from stockholders stating their position on the matter, or in Holding Company Act cases, similar letters from

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150. In the Matter of Charles C. Wright, 1 S.E.C. 560 (1936); but cf., In the Matter of White - Weld Co. et al., 3 S.E.C. 466 (1938), where the Commission sought to prove certain stock transactions through a witness who was the official exchange recorder and who identified the ticker record. Respondent objected on the ground that this was hearsay, not the best evidence, and that the original order slips should be produced. The examiner admitted the evidence "subject to correction" by the respondent, who objected that this unfairly shifted the burden upon him. For criticism of the Commission's allegedly loose rules in respect of hearsay, primary evidence, and relevancy, in manipulation cases, see Redmond, op. cit. supra, note 19, pp. 641-642.

interested individuals, municipalities or State commissioners, will be received, made a part of the record, and be considered. <sup>151/</sup> In the main, however, they are regarded simply as "statements of position" and are not considered as evidence per se. But the facts set out in such written statements may furnish the basis for Commission counsel's examination of the applicant, and the facts thus supported may be put into the record as and through testimony. In other cases, ex parte statements and affidavits will ordinarily be excluded (e.g., the Queensboro Gold Mines case, set out supra, p. 205); but in In the Matter of Missouri-Pacific R.R., 4 S E C \_\_\_\_\_ (1939), a delisting case involving the accuracy of the issuer's balance sheets, the testimony of a commissioner of the Interstate Commerce Commission before a Senate Committee, and a report of that Commission to Congress, both concerning the respondent's accounting practices, were admitted into evidence. According to the Commission's opinion, however, none of its findings

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151. E.g., In the Matter of Teck-Hughes Gold Mines, Ltd., 3 S.E.C. 463 (1938); In the Matter of Applications by the New York Curb Exchange, 3 S E C 81 (1938); In the Matter of the Laclede Gas Light Co., 1 S F C. 671 (1936)

relied exclusively on this evidence. 152/

In general, the Commission rigidly observes its requirement that all the evidence must be in the record; until recently, it has been

152. So far as Commission officials can recall, in no instance have depositions been used, probably because the Commission's subpoena power extends throughout the United States and its Territories, and hearings may be held at any designated place. Nevertheless, Rule VIII(a) of the Commission's Rules of Practice empowers the Commission, for cause shown, to order testimony to be taken by deposition. In general, the following procedure is prescribed by the rules: Application, which may be made by any party, must be in writing, and must set forth the reasons why the deposition should be taken, identify the witness and the time and place he is to be examined, and outline the matters concerning which he is expected to testify. The Commission's order designating an officer, and setting a time and place, must be served upon all parties a reasonable time before the taking of the deposition.

Deponents must be sworn; each question is to be recorded and the answers shall be taken down in the words of the witness. Objections to evidence may be made, and if not made are deemed to have been waived. The officer shall have no power to decide on the competency, materiality, or relevancy of the evidence. The testimony shall be subscribed and certified by the witness; copies of the transcript will be furnished the parties.

Depositions may also be taken and submitted on written interrogatories in substantially the same manner as depositions taken by oral examination. The interrogatories must be filed in triplicate with the application, and must be served on all parties. Within five days, parties may file objections to such interrogatories, or file cross-interrogatories, which in turn must be served upon all parties. Three days are permitted to file objections to the cross-interrogatories. If the deposition is taken upon written interrogatories, none of the parties or Commission counsel shall be present or represented; the officer shall propound the interrogatories to the witness in their order and reduce the testimony to the writing in the witness' own words.

hesitant to invoke official notice. Even in a case where it did so - noticing officially that the ratio of applicant's funded debt to depreciated property account was larger than that of comparable companies, although evidence concerning the comparable companies was absent from the record - the parties involved were afforded an opportunity for a rehearing.<sup>153</sup> On occasion, further, the Commission has taken official notice of previous and connected proceedings. For example, In the Matter of Utilities Power & Light Corp., 4 S.E.C. - (1939) involved an application for Commission approval of a plan of reorganization of U. P. & L. In passing on the plan, the Commission had to consider the solvency of the holding company, and the assets and earnings coverages of the new securities to be issued. After evidence had been taken and the record was closed, but before final determination, U. P. & L., the holding company, applied for and received permission to sell the controlling stock of one of

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153. In the Matter of Consumers Power Co., et al., 4 SEC. (1939). In a prior case involving a banker's spread, however, Commission counsel inserted an exhibit showing the spread for offerings of 16 other utilities offerings during the same year.

its subsidiaries; and that subsidiary filed a declaration, which was ordered effective, for the purpose of raising money to pay off its open account indebtedness to the holding company. The application and declaration were filed in a separate proceeding from the reorganization proceeding; the sale and payment were made pursuant to the application and declaration. The Commission took official notice of the sale and payment in the reorganization proceedings, on the ground that its action could not be objectionable to the persons involved, while on the contrary "to have closed its eyes to those transactions (which were officially recorded in the Commission's files) would have stultified the Commission and might have misled the investors."

But official notice of this nature is invoked very rarely; the more common method, utilized frequently in cases under the Holding Company Act where the Commission's continuing supervision over utilities has resulted in the accumulation of vast public files, is to incorporate file material in the record by general or specific reference. Thus, typically, in a case involving a utility's issue and sale of securities, and acquisition of assets, the applicant or declarant stipulates at the opening

of the hearing and upon the request of the Commission counsel "that any and all files, in connection with this proceeding, need not be copied in the incorporated record . . . and that any information presently in the files of the Commission may be availed of by the staff in connection with its recommendations in these proceedings, and at such time as it has been determined exactly what information has been used, a specific stipulation shall be entered into between counsel . . . setting forth this information and then incorporating that in the record in this proceeding . . ."

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Rule V(e) of the Commission's Rules of Practice provides that the trial examiner or the Commission may, upon notice to all parties, reopen any hearing at any time prior to the Commission's order disposing of the proceeding; while Rule XII(c) states that "the Commission, upon its own motion or

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154. In In the Matter of Missouri-Pacific Railroad Co., 4 S.E.C. - (1939), a delisting case, the respondent's brief in support of exceptions to the examiner's report alleged that the examiner took into consideration matters not in the record but in the public files of the S.E.C. and the I.C.C. The Commission's reply brief did not deny this, but contended that it was immaterial since there was ample evidence in the record to support the findings. The Commission's opinion did not advert to the issue, but apparently relied only upon record material.

upon application in writing by any party or counsel to the Commission for leave to adduce additional evidence which application shall show to the satisfaction of the Commission that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence at the hearing before the Commission or the trial examiner, may hear such additional evidence or may refer the proceeding to the trial examiner for the taking of such additional evidence." In fact reopening is rare, occurring most frequently upon the Commission's own motion in a case of novel impression where the record is incomplete.

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Securing or compelling evidence; periodic reports. Section 19(b) of the Securities Act, Section 21(b) of the Exchange Act, and Section 18(c) of the Holding Company Act, each vests the Commission

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155. In the only reported case discussing the issue, a registrant's motion to reopen for the purpose of taking further testimony and evidence was denied. The Commission stated in its opinion: "Registrant's motion does not show what additional evidence is sought to be introduced, and, therefore, necessarily had failed to show that any such additional evidence is material. In the second place, there is no showing that there was reasonable ground for failure to adduce such evidence at the hearing . . . . Indeed, in view of the action of registrant's officers and counsel in deliberately absenting themselves from the hearing . . . ., any inference to be drawn is to the contrary." In the Matter of Broeze Corporations, Inc., 3 S E C 709, 733 (1938)



with the power, in any investigation or proceeding thereunder, to subpoena witnesses, compel their attendance, and require the production of books, papers, correspondence, or other records deemed relevant or material to the inquiry. Attendance of witnesses and production of documentary evidence may be required from any place in the United States or any Territory at any designated place of hearing. 156 Under Rule V(h) of the Rules of Practice, witnesses summoned before the Commission shall be paid the same fees and mileage that are paid to witnesses in the courts of the United States; fees and mileage shall be paid by the party at whose instance the witnesses appear. The several Acts make the customary provision in the case of contumacy or refusal to obey a subpoena: The Commission may apply to the court of the United States within the jurisdiction of which the proceeding is being held, or within which such person is found, resides, or carries on business,

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156. The Commission's subpoena power extends also to preliminary formal investigations as well as to proceedings ancillary to the decisive hearing and conducted in the nature of a discovery. A contention that the Commission, under the '33 Act, has no power to issue subpoenas in decisive stop order proceedings, but only in preliminary 8(e) investigations, was rejected by the Commission. In the Matter of Broeze Corporations, Inc., 3SEC 709 (1938).

for an order requiring the witness to give the testimony or produce the records in question. Failure to obey the court order is punishable by a contempt proceeding, and in addition under the Exchange Act and the Holding Company Act, a person who wilfully disobeys a valid subpoena shall be guilty of a misdemeanor and subject to a fine of not more than \$1,000, or imprisonment for not more than a year, or both. No person shall be excused from testifying or producing records on the ground of self-incrimination; but no individual shall be prosecuted or subjected to any penalty or forfeiture for or on account of any transaction, matter or thing concerning which he is compelled, after having claimed his privilege against self-incrimination, to testify or produce evidence, except that there shall be no exemption from prosecution for perjury.

The subpoena process is quite frequently used by the Commission in proceedings brought by it, both in respect of testimony and of the production of books and records; <sup>157</sup> since in most proceedings

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157. Wherever possible, the Commission will secure voluntary statements and attempt to obtain access to the files, without resort to subpoena. In this attempt it is considerably aided by a provision of Section 8(c) of the Securities Act that "If the issuer or underwriter shall fail to cooperate, or

(Continued)

brought by the Commission the chief witnesses for respondents are likely to be his business and other associates, requests for subpoenas by respondents are comparatively rare. Each of the Acts expressly empowers not only any member of the Commission but also "any officer or officers designated" by it to issue subpoenas; the designation of the trial examiner in the order for hearing gives him the power to issue subpoenas by virtue of Rule V of the Rules of Practice.

Unlike the policy which obtains at many other agencies, there are scarcely any restrictions upon issuance either of subpoenas ad testificandum or subpoenas duces tecum. Rule V(f) of the Rules

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157. (Cont'd.) shall obstruct or refuse to permit the making of an examination, such conduct shall be proper ground for the issuance of a stop order." No order has been issued on this basis. Cf., Investigatory powers of the Securities and Exchange Commission (1935) 44 Yale L. J., 819, 840. And compare: "Under the Securities Exchange Act . . . every leading securities exchange at the present time retains, as a condition of extending the listing privileges to any corporation, the power summarily to strike its securities off the exchange. And it is not inconceivable that many corporations will be induced to permit examination of their books and papers . . . by the fear that the Commission may exert pressure upon exchange officials to exercise their powers. Moreover, the threat of unfavorable publicity for those who refuse to permit examination may prove a powerful incentive to many persons and corporations to permit them." Ibid.

of Practice simply states that applications for the former must be in writing, while Rule V(g) prescribes that applications for the latter must be written and must specify as nearly as may be the documents desired and the facts to be proved by them, "in sufficient detail to indicate the documents desired." Commission counsel, <sup>158</sup> parties and interveners may all request subpoenas, and if they are ad testificandum, they are issued automatically. Subpoenas are issued ex parte; neither the issuance nor the

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158. In fact Commission counsel are apparently under greater restrictions in obtaining subpoenas duces tecum than parties. The Commission's Enforcement Manual includes extensive instructions to its counsel directing them to limit such requests and to specify precisely their purpose, in order to avoid any appearance of engaging in a "fishing expedition." But cf., Bank of America National Trust & Savings Ass'n. v. Douglas, 105 F. (2d) 100 (App. D.C., 1939), where the court criticized the Commission's issuance of a subpoena duces tecum which would have required bank officers in San Francisco to produce in Washington records of numerous transactions and some 200 loans over a ten-year period. The court stated that "It is perfectly clear, we think, that compliance with these demands will, for all practical purposes, close the bank." In justification of the breadth of these subpoenas, it is stated that the Commission staff was faced with the customary dilemma of not being able to know in advance just which of the records were relevant; accordingly, the subpoena was to serve as the basis of inspection in San Francisco of all documents requested, and the selection for transmission to Washington of only those records which were immediately material.

receipt or contents of an application may ordinarily be disclosed by the trial examiner to any one other than the applicant; the purpose of this is, of course, to prevent charges that the Commission counsel could take advantage of requests by other parties, could learn the names of the witnesses to be called or the nature of the records to be produced, and could invoke its power of ancillary investigation to subpoena the same witnesses and records and ascertain the respondent's case in advance. 159

Unlike the subject matter of proceedings before certain other agencies, the nature of the matters with which the Commission deals is rarely such as to make possible parties' utilizing the subpoena process to delve into confidential material whose disclosure would do great harm. Hence, the absence of restrictions upon the issuance of subpoenas and the policy of ex parte determination of applications, are probably unobjectionable. To a considerable extent, too, the obligation of the applicant to bear the witness' expenses and, in the case of subpoenas duces tecum, to specify the material sought, diminish the danger of improper or over-frequent resort to the subpoena process.

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159. But cf. Redmond, op. cit. supra, note 19, p. 639.

In addition to its subpoena powers, the Commission is vested by the several Acts with power to inspect premises, inspect and audit books and records, and compel the making of periodic reports and the keeping of records. Inspection of premises is permissible under the Commission's general powers of investigation. Inspection frequently occurs in cases involving registration statements where the valuation of property is in issue, and, as already noted, it is customary for Commission engineers regularly to inspect mining, oil, and gas properties to check values and production estimates involved in registration of securities. Further, the Commission has the power to inspect records (a) of registrants, underwriters, or any other persons in respect of any matter relevant to an examination under Section 8(e) of the Securities Act, which permits preliminary investigations in order to determine whether an order should be issued under Section 8(d) to stop the effectiveness of a registration statement; (b) pursuant to Section 17(a) of the Exchange Act, of national securities exchanges, their members and brokers and dealers transacting business through the medium of such members; of registered securities associations; and of registered brokers and dealers;

and (c) pursuant to Section 15(f) of the Holding Company Act, of registered holding companies, their subsidiaries and affiliates, mutual service companies, their affiliates, and every person whose principal business is the performance of service, sales, or construction contracts for public-utility or holding companies. <sup>160</sup> Under Bank of America National Trust & Savings Ass'n. v. Douglas, 105 F. (2d) 100 (App. D.C. 1939), the Commission is entitled access to, and examine, confidential reports of the Comptroller of the Currency, if the Secretary of the Treasury agrees.

Since a major purpose of the Acts is to assure public disclosure, an important part of the Commission's work is devoted to prescribing, receiving, examining, and publishing periodic reports. Under Section 13(a) of the Exchange Act, every issuer of a security registered on a national securities exchange is required to file reports to keep current information and documents embodied in its original registration statement, as well as annual or quarterly reports. Section 15(d) of the same Act prescribes

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160. Under its powers to secure "information as a basis for recommending legislation" and making reports to Congress (*supra*, pp. 20-21), the Commission has also exercised its right of examining books and records of a variety of other classes of persons.

that registration statements filed under the '33 Act must contain an undertaking by the issuer to file similar information and reports if the issue aggregates \$2,000,000 or over; Section 16(a) requires officers, directors and 10 per cent stockholders of issuers having any equity security registered on a national securities exchange to file reports indicating their ownership and changes in their ownership of such securities. Section 17(a) of the '34 Act provides that every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every registered broker or dealer "shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports," as the Commission may prescribe. Even more sweeping are the Commission's powers under the Holding Company Act. Section 14 provides that every registered holding company and every mutual service company must file with the Commission such annual, quarterly, and other periodic and special reports, the answers to such specific questions and the minutes of such directors', stockholders' and other meetings, as the Commission may prescribe. The Commission may require that such reports be certified



by an independent public accountant. Section 15 requires every registered holding company subsidiary, or affiliate, to make, keep and preserve such accounts, cost-accounting procedures, correspondence, memoranda, papers, books and other records as the Commission may prescribe. The Commission may prescribe the account or accounts in which particular outlays, receipts and other transactions shall be entered or credited and the manner in which such entry, charge or credit shall be made; in addition, it may prescribe uniform systems of accounts for registered holding companies, subsidiaries and mutual service companies. 161

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161. See the Commission's Uniform System of Accounts for Public Utility Holding Companies (1938; 35 pp.); and Uniform System of Accounts for Mutual Service Companies and Subsidiary Service Companies (1936; 24 pp).

The trial examiner's report: (1) In general; its nature. Rule IX(b) of the Commission's Rules of Practice requires that, following any hearing (including those in which respondent has failed to appear) before a trial examiner, the latter shall file a report containing his findings of fact;<sup>162</sup> no report is, however, required by the rule, in (1) hearings under the Holding Company Act; (2) hearings on the question of the postponement of the effective date of registration of a broker or dealer under Section 15(b) of the Exchange Act, pending final determination whether such registration shall be denied; and (3) hearings upon applications for confidential treatment. A trial examiner's report in either group (2) or (3) would clearly be superfluous and not feasible. In group (2), there will, of

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162. Perhaps chiefly because the trial examiner plays so small a part in the ultimate disposition of the case, oral arguments before him are rare. The parties are not entitled to such argument as a matter of right, but it is usually permitted, when requested. In difficult cases, the examiner may himself request oral argument before him. Sometimes where the party may find it inconvenient to come to Washington to argue before the Commission, he will argue before the examiner, the argument then being embodied in the record and transmitted to Washington. Briefs are filed to accompany requested findings, as described below, p. 236

course, be a report on the issue of whether permanently to revoke the registration, but since the purpose of the statutory permission to suspend pending such final determination is to allow quick action, it is obvious that if effect is to be given to the provision at all, the temporary suspension should not await the filing of a report. As for the third group, issues in the hearings on applications for confidential treatment are clear-cut, questions of fact rarely arise, and the determination must be based chiefly on policy.

Much the same considerations obtain in the majority of cases under the Holding Company Act. These cases arise upon applications or declarations, and as already noted, speed is ordinarily of the essence. As has been described by officials of the Commission,<sup>163</sup>

"Before the application is filed the Commission has in its files most of the statistical data relevant to the case, and any additional information bearing on the particular issues can be obtained before the hearing by informal conferences between the staff and the representatives of the applicant . . . . Experience has shown

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163. Lane and Blair-Smith, op. cit. supra, note 72, at pp. 716-717.

that in such cases conflicting contentions arise generally from disagreements on matters of policy, or on the inferences to be drawn from undisputed facts, rather than from controversies in matters of basic fact. Such as are presented need no resolution by a trial examiner's report, but are peculiarly within the province of the Commission to decide . . . . . The preparation by a trial examiner of findings of fact and conclusions of law would be a useless and time-consuming formality. The interest of the applicant, intent upon the prompt consummation of a business transaction, or upon a speedy determination of his status under the law, demands that all unnecessary formalities be dispensed with."

Thus it is to be noted that in Holding Company Act cases, omission of a report is primarily in the interests of the applicant or declarant, rather than of the Commission; indeed, in all such cases, the applicant or declarant is said to have a right to a report, and a report will be prepared unless the applicant or declarant signs a waiver at the opening of the hearing.<sup>164</sup> Such waivers are customarily

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164. A typical waiver utilized in such hearings is as follows:

"In connection with the foregoing proceeding, now pending before the SEC, the undersigned, being attorney for the above-named applicant and its duly authorized agent, hereby waives any right on behalf of the above-named party which it may have,

"(1) to have prepared and submitted to it any report by the trial examiner;

"(2) to have prepared and submitted to it proposed findings of fact by the Commission,

(Continued)

signed, but in cases involving applications for exemptions (where, since the mere filing of an application in good faith temporarily entitles the applicant to the exemption requested, delay rather than speed is the interest of the applicant) parties have increasingly requested and received reports. In addition, where the Utilities Division has in advance of hearing indicated that it contemplated taking a position adverse to the declarant or applicant, and in cases brought by the Commission to declare a

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164. (Cont'd.) or requests for findings of fact by counsel to the Commission;

"(3) to file a brief with the Commission prior to the making of findings of fact and the entry of orders by the Commission; and

"(4) to oral argument before the Commission prior to the making of findings of fact and the entry of orders by the Commission.

"Nothing herein shall be deemed a waiver of

"(1) the right to petition for a rehearing on any one or more of the following grounds: (a) that any findings of fact are not supported by substantial evidence; (b) that additional evidence should be adduced; or (c) that any order is contrary to law;

"(2) the right to file a brief with and orally argue before the Commission in respect of any such petition for rehearing;

"(3) the right to except or urge any objections to, or apply to a court for a review of, any findings or order or orders of the Commission or any parts thereof; or

"(4) any other rights except those expressly waived herein."

If, in the course of the hearing, it appears that the staff may recommend adverse action, the applicant or declarant is always at liberty to recall the waiver.

company an affiliate, a subsidiary, or a holding company, reports may be filed. Finally, the applicant or declarant is afforded further protection against surprise in the event that the staff, or the Commission itself, should decide subsequently to the hearing to take an adverse position or impose new conditions, by the Commission's communicating the proposed position and affording an opportunity for conference, briefs and arguments thereon.<sup>165</sup>

Under the Commission's Rules of Practice, the trial examiner's report is to contain only his findings of fact, and until rather recently, the report was limited to these findings, a limitation which, however, was interpreted as including "conclusions of fact" (e.g., whether a given item in a registration statement is true or false) as well;

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165. It is difficult to find any sound basis for following one practice in applications and declarations under the Holding Company Act and another in applications for withdrawal from listing, and for extension or termination of unlisted trading privileges, under the Exchange Act, where hearings are also always held. The issues are narrow and technical, the policies of the Commission well crystallized, and testimonial evidence of small moment in such cases. The recommendation for decision in this case is, in any event, usually prepared by the unlisted securities unit, to which a trial examiner's report is not likely to be useful. The procedure adopted under the Holding Company Act would seem to be adaptable to this type of case as well.

the ultimate conclusions (e.g., whether the operations of a utility are predominantly intrastate) and recommendations are usually omitted. More recently, the reports have tended to include recommendations in respect of the disposition of the case. Such recommendations, which become of particular importance in proceedings under Section 19 of the Exchange Act, where the Commission may delist a security or suspend or expel a member from an exchange, have sometimes been attached by the examiner under the somewhat apologetic heading of "Remarks." Further, in In the Matter of Applications by the New York Curb Exchange, 3 SEC 81 (1938), the examiner's report included legal conclusions; the applicant objected to the report on the ground that the examiner thereby exceeded his powers. The Commission rejected the contention, stating that "We feel that the action of the examiner in advising us of his view of the evidence and of his opinion that it fell short of the [statutory] standards . . . was within the scope of his duties . . . ." Even where "ultimate conclusions" and recommendations are included in the report, however, there is ordinarily no statement therein of principles of law involved.

A second characteristic of the report is that, as its name indicates, it is a trial examiner's

report, and not an intermediate report. Its preparation is almost entirely a one man job except in so far as it may reflect requested findings, and as the examiner may consult non-participating experts--accountants, engineers, and the like--on technical problems.<sup>166</sup> Even when such consultation does occur, the experts' opinions are sought only in the abstract; the particular case as such is not put before the experts by the examiner. Nor, it is stated, does the examiner rely on the experts' opinions, but rather the process is analogized to consulting a bibliography which will lead the examiner to texts and written authorities which may throw light on his problem. Even to a greater extent than obtains in the course of the hearing, the examiner, in the post-hearing phases, is completely free of supervision. The report is not submitted to any superior in the Commission prior to its completion for editing as

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166. The examiners are strictly instructed not to consult with Commission counsel, by a Commission minute, dated May 22, 1936, which stated: "It was directed that in the future all trial examiners' reports shall be prepared by the officer designated by the Commission to conduct the proceedings, without aid from or consultation with Commission counsel. It was directed, however, that such procedure should not interfere with the submission by Commission counsel of suggested findings of fact . . ." This minute is also understood to prohibit consultation with accountants, analysts, and others of the Commission's staff who have participated in the proceeding.



to form or substance or for any other purpose, nor even in the most general terms are there instructions in respect of the form or substantive contents of a report.

These two characteristics--its omission of effective discussion of the applicable law and of the recommendations concerning the disposition of the case, and its complete individuality--coupled with its "purely advisory" nature [Rule IX(c), discussed infra, pp.240-241] acutely raise the issue whether the trial examiner's report is an effective document, useful either to the parties or the Commission. At the outset, it may be observed that perhaps no criticism is more commonly met, among Commission staff members as well as among persons outside the Commission, than that directed at the calibre of the trial examiners' reports. They are charged with being poorly prepared, poorly reasoned, and of virtually no significance in the ultimate disposition of the case. The issues discussed in the report may not be, and too often are not, the issues which move the Commission.

Whether the fault lies with the restrictions upon its content, the method of preparation, or the competency of the individual examiners themselves is difficult categorically to state. Yet

it seems clear that if a report is to serve as a useful document upon which intelligent argument can be focussed, it must go beyond mere findings of fact<sup>167/</sup>--which in many Commission cases are of only minor significance. And if it is to include discussions of law, conclusions, recommendations, and matters of policy which are to be useful either in informing the parties or in assisting the Commission, there would seem to be some doubt whether the present insistence upon individual effort is wise. It is, for example, inconceivable that, under the present arrangement, a trial examiner will be able to prepare single-handed an effective report in integration and simplification proceedings under the Holding Company Act, where new areas of regulation are to be charted, and where questions almost purely of expert judgment and policy are involved. To a less marked extent, the same is true of other types of cases--Commission proceedings to delist, or to expel a member from an exchange, where there is a wide choice of sanctions, or other cases under the Holding Company Act begun by application or declaration, where the issues are usually confined to

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167. But a contrary view is held by some Commission officials who believe it both improper and unwise to extend the scope of the trial examiner's reports, since their sole function should be to make findings of fact, much in the fashion of a special master in equity. To permit examiner to make recommendations, it is urged, would not narrow the issue since it would be unwise for respondents to proceed on the assumption that the Commission would agree with the examiner.

whether a proposed transaction is in the public interest and financially desirable. Indeed, it may be conceded that on findings of fact the examiner's judgment should remain unfettered, and that in respect of all other elements of the report persons who participated actively in the conduct of contested cases should be excluded. But a middle ground remains: While it may be undesirable for the Commission itself, which must make the ultimate decision, to participate in the intermediate report, it would seem possible for a Chief Trial Examiner to act as liaison between the Commission and the examiner, to keep abreast of the Commission's policies, and to supervise the preparation of the report in respect of matters other than findings of fact. And just as a Chief Trial Examiner should be available to assist in shaping the document in respect of policies, so there should be less timidity concerning the use of other experts, who perhaps, to preserve their insulation, might be attached to the trial examiner's staff. With somewhat freer utilization of policy-making officials and technical experts (and it can scarcely be expected that an examiner before whom must come the variety of cases which the Commission hears can combine all the expertise of the agency), the report might more likely represent the best that a group can bring to it, rather than, as is apparent now, an individual effort of little significance.

(2) Requested findings. Except where the issue is temporary suspension of a broker-dealer registration pending final determination as to revocation, parties and Commission counsel are permitted to submit requested findings to the trial examiner; where a report is to be prepared, proposed findings are almost invariably filed, and sometimes in Holding Company Act cases where no report is to be issued, such findings may be submitted. <sup>168</sup> Rule IX(e) of the Commission's Rules of Practice prescribes the procedure for the submission of requested findings: Any party or counsel to the Commission may submit "a statement in writing in terse outline setting

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168.. In cases under the Holding Company Act, Commission counsel may often file requested findings where the Utilities staff has decided to take a position adverse to the applicant and, indeed, such findings are, in effect, a proposed decision in the absence of a trial examiner's report. E.g., In the Matter of Houston Natural Gas Corp., 3 SEC. 664 (1938) (application for exemption as a predominantly intra-state utility denied); In the Matter of Northeastern Water and Electric Corp., 3 SEC. 823 (1938) (application for acquisition of securities granted on condition that certain underwriters' fees be abandoned). The importance attached by the parties to such findings requested by Commission counsel is indicated by In the Matter of David C. Patterson, et al., 3 SEC 1014 (1938), where the request, in substance, was that a plan of reorganization should be disapproved as unfair. Immediately thereupon, applicants filed a new plan upon which new hearings were held; the new plan was approved.

forth such party's request for specific findings" within five days after the receipt of a copy of the transcript of the testimony.<sup>169</sup> The requested findings may be, and customarily are, supported by briefs which must include page references to such portions of the record as may be relevant. Where no trial examiner's report is to be filed, requests for specific findings not briefed may be regarded by the Commission as waived. A copy of such requested findings and brief must be served upon each party and upon Commission counsel,<sup>170</sup> and five days are customarily allowed for the filing of reply briefs.

Even if the parties and the Commission counsel do not on their own motion file requested

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<sup>169</sup>. The five-day period is liberally extended and quite often not observed; it is believed to be useful, however, as a starting point. Requests for extension of time, although virtually automatically granted, must be passed on by the Commission. No reason appears why this task cannot be delegated to an administrative officer.

<sup>170</sup>. It was not formerly the practice of the Commission to require requested findings to be served upon the parties. In one case, respondent moved, two months after the filing of the trial examiner's report, that all requested findings previously filed with the examiner be submitted to it and made a part of the record. The Commission denied the motion, stating that there was no attempt of Commission counsel to conceal their position since the nature of the charges were known to the respondent throughout. In the Matter of Missouri-Pacific Railroad Co., 3 SEC 854 (1938).

findings, they may be directed to do so by the examiner or the Commission. Such directions are not infrequent; trial examiners state that they have found the requests filed to be helpful in confirming and defining the issues, and that they are useful in persuading the attorneys to exercise some self-restraint, since if they must file requested findings, they may abandon some of the less important contentions made by them during the hearing. In one recent and complex case under the Holding Company Act, the Commission, at the suggestion of the opinion attorney analyzing the record, itself requested the parties and Commission counsel to file proposed findings in the hope of clarifying and defining the issues.

(3) Circulation of the report; exceptions.

Under Rule IX(b) of the Rules of Practice, the trial examiner's report is required to be filed by the examiner "within 10 days after service upon him by the Secretary or other duly designated officer of the Commission of a copy of the transcript of the testimony." The time limitation is directory rather than mandatory; applications for extension filed by the examiner are granted ex parte and almost automatically by the Commission itself in executive session, after reading of the application by the recording

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secretary. Rule IX(d) prescribes that, upon its completion, a copy of the report shall be forthwith served upon each party and on counsel to the Commission. Except for such service, however, the report is not made available to the public until the date of oral argument before the Commission, or, if the case is submitted without oral argument, until the date of final determination by the Commission. Until such dates, the report is regarded as being for the confidential use of the Commission, the parties, and counsel.

Within five days (or longer upon application,  
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which is normally granted) after receipt of a copy of the trial examiner's report, any party or counsel may file exceptions to the findings of the trial examiner, or to his failure to make findings, or to the admission or exculsion of evidence. A copy of such exceptions shall be served forthwith on each party and on counsel to the Commission. It is to be noted that Commission

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171. Again, little reason is discernible why the Commission should devote time, however small in each case, to matters of this nature, especially there such applications are hardly ever refused.

172. Rule XIII(d) automatically grants five additional days to parties residing in Montana, Idaho, Wyoming, Colorado, New Mexico, Utah, Arizona, Nevada, Washington, Oregon and California; and 20 additional days to parties who reside "beyond the confines of the continental United States." Exceptions filed six months after the report and four months after oral argument, with no application for extension, will not be considered. In the matter of Breeze Corporations, Inc., 3 SEC 709, 731 (1938).

counsel, as well as other parties, frequently except to reports; indeed, it is the general policy of the former to accept to all findings adverse to the position taken by them. There is properly no attempt by the Commission counsel suddenly to assume an adjudicatory function after the close of the hearing; rather he continues in the role of an advocate to press his position before the Commission.

Rule XI(a) of the Rules of Practice provides that any party to a proceeding or counsel to the Commission may file a brief in support of his contentions and exceptions within fifteen days from the date of service of the trial examiner's report. Under Rule XI(b), all such briefs shall be confined to the particular matters in issue, and each exception which is briefed shall be supported by "a concise argument and by citation of such statute, decisions and other authorities and by page references to such portion of the record, as may be relevant." If the exception relates to the admission or exclusion of evidence, the substance of the evidence shall be set forth in the brief with appropriate references to the transcript. Rule XI(c) provides that exceptions not briefed in accordance with Rule XI may be regarded as waived.



Proceedings before the Commission:

(1) The function of the trial examiner's report.

As the Commission has persistently been at pains to point out - through its rules of practice [Rule IX(c)], through an announcement to that effect stamped on the first page of every report, through a long series of decisions, and through speeches and statements of its officials - the trial examiner's report is advisory only and in no way binding upon the Commission. Nevertheless, certain rules have been prescribed which are intended to relieve the Commission of the burden of extended consideration where there is no contest. Thus, Rule V(d) provides that exception to any ruling on the admission or exclusion of evidence must be noted before the trial examiner in order to be urged before the Commission, while Rule X(b) somewhat modifies this by providing that "Objections to the admission or exclusion of evidence not saved by exception at the hearing for the purpose of taking evidence and included in the exceptions filed pursuant to this rule will be deemed to have been abandoned and may be disregarded" (underscoring supplied). Similarly, under the same rule, objections to the findings of the trial examiner or to his failure to make findings not saved by exception will

be deemed to have been abandoned and may be disregarded.

In fact, the Commission's practice in these respects varies; while it is stated that it does not feel bound to discuss at length objections not saved by specific exceptions and brief, in its discretion it may consider and discuss in its opinion and findings any relevant question which arises in the record, whether or not the question is dealt with in the examiner's report or in a specific exception. Thus, on the one hand, in In the Matter of Clyde Beall Mitchell, 1 SEC 858 (1936), where respondent did not appeal from the denial of his motion to stay proceedings, nor make any reference thereto in his bill of exceptions to the trial examiner's report, the Commission in its opinion stated that "In the light of these facts it is our conclusion that any further consideration of the issues is here unnecessary." Similarly, in In the Matter of United Combustion Corp., 3 SEC 1062 (1938), the trial examiner's report found that two of the items in a registration statement were not deficient. Commission counsel failed to except and the Commission accordingly did not consider these

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items. On the other hand, in In the Matter of Queensboro Gold Mines, Ltd., 2 SEC 863 (1937), in which respondent had at the hearing objected to Commission counsel's motion to amend but had failed to take exceptions thereafter although the trial examiner's report contained findings in respect of the new allegations, the Commission nevertheless considered and sustained the objection. 174

In any event, even if there is a total absence of exceptions, briefs, and oral argument, the trial examiner's report does not become binding; the Commission must itself enter an order in every case and, as stated by its General Counsel, the record in

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173. It is interesting to note that there is apparent a tendency to invoke its rule of non-consideration more strictly in respect of failure to except by Commission counsel than by other parties. As a general rule, exception must be taken by the former to be considered. Cf., In the Matter of Unity Gold Corp., 1 SEC 25 (1934).

174. This result may in any event, be impelled by the curious wording of Rule X(b), which requires that objections (1) to the findings of the examiner or to his failure to find, or (2) to the admission or exclusion of evidence, must be made and exceptions filed. Nothing is said about motions, so that at least under the terms of the rule, objections and exceptions in respect of motions are not required. But Cf., the Clyde Beall Mitchell case, set out supra, p. 246, where failure to appeal from or except to a motion to stay proceedings was deemed to have relieved the Commission from consideration of the issue.

each case is reexamined meticulously.<sup>175</sup> In its discretion, however, where the person adversely affected by the report makes no move toward obtaining further consideration, the Commission may adopt the findings of the trial examiner in their entirety; customarily, however, it will append several pages of its own discussion.<sup>176</sup>

A fortiori, where exceptions are filed, the Commission considers the case, for all practical purposes, de novo, and in the main the report is utilized only as an incidental check. The Commission is wholly free to disregard the report and not infrequently the ultimate decision will proceed on a theory entirely different from that of the report.

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175. Even when the respondent does not appear at all, and takes no exceptions, the Commission is careful to point out in its ultimate opinion that its decision is based "on an independent review of the record." E.g., In the Matter of Ralph C. Kent, 4 SEC 204 (1938).

176. E.g., In the Matter of Continental Distillers & Importers Corp., 1 SEC 83 (1935); In the Matter of American Gyro Co., 1 SEC 83 (1935); In the Matter of General Income Shares, Inc., 1 SEC 110 (1935); but cf., In the Matter of Trenton Valley Distillers Corp., 3 SEC 71 (1938). Where the Commission does append its own opinion, it does so "in the public interest and for the protection of investors" and in order that its own views of the issues may be made known. In the Matter of Gold Hill Operating Co., 1 SEC 668 (1936); In the Matter of Virginia Gold Mining Co., 2 SEC 855 (1937).

Although complete reversal is rare,<sup>177</sup> it is estimated that in almost 90 per cent of the cases, the Commission's decision differs in some ultimate conclusions from the examiner's report.

Under such circumstances, a serious question arises whether the trial examiner's reports in their present form are much more than an idle gesture. Their utility as effective prognoses of the Commission's ultimate attitudes and as devices to narrow the cases down to the moving issues has already been discussed (supra, p.232). Further, it is clear that

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177. In the cases printed and reported in the volumes of decisions covering the Commission's work until January 31, 1939, so far as can be ascertained only in eight cases was the entire report reversed. In the Matter of Mutual Industrial Bankers, Inc., 1 SEC 26 (1934) (Stop order; Commission counsel's exceptions sustained); In the Matter of Charles C. Willson 1 SEC 402 (1935) (Refusal of broker registration; Commission counsel's exceptions sustained); In the Matter of Mineral Products, Inc., 1 SEC 479 (1936) (Refusal order; Commission counsel's exceptions sustained; In the Matter of American Terminals and Transit Co., 1 SEC 701 (1936) (stop order; Commission counsel's exceptions sustained); In the Matter of American District Telegraph Co., 2 SEC 450 (1937) (application by issuer to terminate unlisted trading privileges; applicant's exceptions granted); In the Matter of San Francisco Curb Exchange, 3 SEC 21 (1938) (same); In the Matter of Providence Gas Co., 4 SEC 395 (1939) (same); In the Matter of Joseph H. Dorn, 3 SEC 258 (1938) (proceeding to disbar for improper conduct; respondent's exceptions sustained). Three of these cases involved conflicts of factual testimony and credibility (Willson, American Terminals and Dorn); the rest were concerned with ultimate conclusions, inferences and policies.

they have been so treated by the Commission that they are ineffective as a means to relieve the latter of any burden of consideration. Where no exceptions are taken, it would scarcely seem necessary for the Commission to reexamine the record de novo; surely if the parties themselves take no further action, it is difficult to justify the Commission's expenditure of its valuable time in beginning all over again.<sup>178</sup>

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178. But compare the belief of one Commission official that "to accept the examiner's conclusions, even though unchallenged by the petitioner or the respondent, would be tantamount to an abdication by the Commission of its duty to decide cases."

(2) Oral argument; briefs. Except in cases involving applications for confidential treatment, oral argument before the Commission may be had as a matter of right. Rule XII(a) provides that written request must be made for such argument within the time provided for filing the original briefs, except in a case where the issue is whether a broker-dealer registration should be postponed pending final determination as to denial, where the request must be made before the close of the hearing proper. In confidential treatment cases, oral argument may be had within the discretion of the Commission; it is said that if the Commission is dubious about granting such applications, request will be granted, although in fact none of the few requests thus far made have been denied.

In almost all proceedings instituted by the Commission against a respondent, the right to argument is exercised; in routine Holding Company Act cases it is customarily waived (see supra, footnote 164), and requests are very infrequent in applications for withdrawal of listed securities and for extension or termination of unlisted trading privileges. One hour is usually allowed each party, but the period may be extended in difficult or complex cases. The scope of the argument is not

limited by rule, but it must, of course, be confined to the issues in the case. Commonly when oral argument is held, a staff attorney representing the division or unit in whose jurisdiction the subject-matter lies will also argue. Where the case involves a registration statement (stop or refusal orders), or in Holding Company Act cases, the Commission counsel who participated in the hearing will argue orally, even if he is a regional attorney; but in broker-dealer registration cases, where the hearings are normally held in the field and tried by a regional attorney, the expense would be too great and, accordingly, an attorney attached to the over-the-counter unit in Washington will usually make the argument before the Commission. It is said that no serious duplication is caused thereby, since the arguing attorney will commonly be the one who initially prepared the case for hearing, and who has kept continuous watch over the hearing and read the record from day to day. The attorney from the General Counsel's office who is to analyze the record and draft the opinion, and his supervisor, also attend the argument; neither, however, participates.<sup>179</sup>

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179... Ordinarily, oral argument is held before at  
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As has already been described, briefs may be filed as a matter of right except on the issue of temporary postponement of broker-dealer registrations and, indeed, must be filed in support of exceptions to the trial examiner's report. All briefs are required to be "confined to the particular matters in issue"; any scandalous or impertinent matter may be stricken on order of the Commission. If the brief contains more than 10 pages, it is required to include an index and table of cases; no brief shall exceed 60 pages except with the permission of the Commission, but such permission is normally granted. If briefs are typewritten or mimeographed, 10 copies are required; if printed, 20 copies; but in confidential treatment cases, only seven copies need be filed in any instance.

The briefs are filed before oral argument and, in practice, provide the means whereby the Commission may familiarize itself with the issues.

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(continued) least three, and more commonly five, commissioners. In one case, argument was held, by stipulation of the parties, before a single commissioner /In the Matter of Howard M. Roberts, 1 SEC 263 (1935)/, and in another, it was held before two commissioners upon the understanding that a transcript of the argument would be submitted to such additional commissioners as would constitute a quorum /In the Matter of American Gas and Power Co., et al., 3 SEC 911 (1938)/.

The rules prescribe that they must be filed within 15 days from the date of service of the trial examiner's report or, if there is no report, within 15 days after the filing of the transcript of the testimony. Five additional days are permitted to persons residing in the far western states and twenty to those outside the territorial limits of the United States. Further, the time limits are commonly extended by the Commission in executive session upon request. Copies of the briefs must be served upon all the parties and counsel to the Commission (who himself usually files a brief); reply briefs may be filed within five days thereafter as a matter of right except in confidential treatment cases, where special permission from the Commission is necessary. Rule X(b) prescribes that reply briefs shall be confined to matters in the original briefs of opposing parties. In addition, supplemental briefs may in any proceeding be filed with the consent of the Commission.

Proceedings prior to the decision; analysis of the record; drafting the decision. The Commission, in general, as indeed it must with its present workload, follows the customary practice of utilizing subordinates to assist in formulating the ultimate

decision and opinion; normally neither a single commissioner<sup>180</sup> nor the whole Commission undertakes the task of reading the entire record, although each usually reads the briefs and exceptions. To which subordinates the case is thus assigned depends on its history and nature: Roughly, for the purposes of the post-hearing procedure, there are two categories of cases - those which are "contested" and those which are "uncontested". In general, "contested" cases are assigned to the interpretative section, a group of approximately 25 attorneys in the General Counsel's office, who are completely insulated and who have had no part in any of the previous phases of the case;<sup>181</sup> while "uncontested"

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180. Until recently, the Commission utilized a modified form of a one-commissioner system whereby each commissioner undertook primary responsibility for a particular type of case. This system has since been largely abandoned.

181. It is emphasized that the interpretative section is not a review section; only approximately 12 of the 25 are at any given moment assigned to analyzing records and drafting opinions, while the rest are engaged in other interpretational work, writing briefs, and perhaps even occasionally engaging in investigations. Their work is thus varied in order to avoid their becoming "divorced from reality" and in order to keep them abreast of other Commission work. The opinion work is under the direction of a supervising attorney and an Assistant General Counsel; a maximum of 150 formal opinions annually are prepared.

cases are handled by the same division or unit in whose jurisdiction the subject-matter lies, and, possibly, by the same attorney who prepared the case for hearing and acted as Commission counsel. But the touchstone of "contests" is not an infallible one and variations occur which cannot be explained by any characteristic inherent in the case.

More particularly, cases begun by the Commission under the '33 Act to refuse or suspend the effectiveness of a registration statement are assigned to the interpretative section whether or not there is a contest (i.e., whether or not the registrant has appeared, defended and excepted); but uncontested cases (where there is no appearance at all) brought by the Commission to deny or revoke a broker-dealer registration are handled by the over-the-counter unit within the limits of the availability of its staff. Cases begun by applications or declarations under the Holding Company Act are handled by the same attorney in the Public Utilities Division who participated in all the prior phases except in those cases where the staff has proposed to the applicant or declarant an adverse position in which the applicant or declarant has refused to acquiesce. It is to be noted that the mere fact that adverse conditions are, or may be, imposed upon

the applicant or declarant will not involve assigning the case to the interpretative section; if such conditions have been communicated to the applicant or declarant, and the latter agrees, however reluctantly, the matter remains in the hands of the Public Utilities Division. The post-hearing phases of cases involving applications for withdrawal of listed securities are, if the application is unopposed, handled by the unlisted securities unit, but all cases relating to applications for the termination of unlisted trading privileges, whether or not such applications are altogether unopposed, or are opposed only by parties other than the Commission staff, are assigned to the interpretative section rather than the unlisted securities unit.

Just as some "uncontested" cases, as described in the previous paragraph, may be assigned to the interpretative section, so groups other than that section may participate in the post-hearing phases of "contested" cases. Until a few months ago, all applications for the extension of unlisted trading privileges were handled by the interpretative section in the same manner as applications for the termination of such privileges; recently, however, this practice has been abandoned and the cases after hearing are now handled by the unlisted

securities unit, whether or not the applications are opposed. To some extent, too, the unlisted securities unit or the over-the-counter unit may engage in post-hearing activities in contested cases within their jurisdiction which parallel or even duplicate the work of the interpretative section. Thus in all cases relating to applications for termination of unlisted trading privileges, the unlisted securities unit reads the record, prepares a memorandum summarizing the case, and may even report orally to the Commission before the latter turns the matter over to the interpretative section. In like manner, in contested broker-dealer registration cases, the over-the-counter unit may read the record and present a recommendation to the Commission, although the primary responsibility rests with the interpretative section. It is to be noted that in both the situations described in this paragraph where groups other than the insulated interpretative section may participate in the post-hearing phases of contested cases, it is unlikely that the participant will be the same person who acted as Commission counsel at the hearing, since hearings in those types of cases are customarily held in the field, and, as already described, are there tried by regional attorneys

With the general outlines of the Commission's policy of allocating post-hearing duties among the various groups of the staff there can be little quarrel. Proceedings brought by the Commission against a person - to stop the effectiveness of a registration statement, to delist a security, to expel a member from an exchange, to revoke a broker-dealer registration, and the like - are in the nature of prosecutions resulting in the imposition of more or less drastic sanctions, and, accordingly, it seems desirable internally to insulate the adjudicating staff from the prosecuting staff, and to bar the latter from post-hearing participation. On the other hand, in cases begun by application or declaration under the Holding Company Act where no adverse action is contemplated, the need for speed, the advantages of utilizing the individuals who have lived with the case, the complete absence of harm from prejudgment (since there is no opposition), and the needlessness of throwing the issues into new and less expert hands solely for purposes of duplication, all combine to make the practice of assigning the matter to the group which handled the case sensible and desirable. But there are cases in each category--that category begun by the Commission against a person, and that begun by application--which fall in between

these clear-cut extremes, and the practices are somewhat more open to question. Thus on the one hand, there would seem to be some doubt concerning the occasional participation of the over-the-counter unit in cases involving the revocation or denial of broker-dealer registration. For both that unit to read the record and prepare a recommendation in contested cases involves a duplication of the work of the interpretative section, although the practice is defended on the ground that in order to keep abreast of how its cases are conducted in the field and to learn how particular types of cases evolve in the course of hearing for use in future investigations, the over-the-counter unit, which would otherwise be isolated from the hearings on actions over which it has charge, must in any event read the record. But at least in contested cases, its participation would seem to be better confined to the orthodox channel provided it for influencing the final decision--the channel of requested findings and exceptions to the trial examiner's report. Different considerations prevail, however, in "uncontested" cases instituted by the Commission: Since, as already discussed, it would seem to be quite proper for the Commission to enter an order forthwith upon the basis of the notice of hearing, there would seem to be no reason why that



order could not be prepared by the appropriate division or unit, particularly since, in that type of case, little choice of sanction is available and either a stop order or a revocation of a broker-dealer registration would result. Thus, again, the Commission seems justified in allowing the post-hearing phases of uncontested broker-dealer registration cases to remain in the hands of the over-the-counter unit which treats of such cases in their earlier phases. And, finally, it would seem desirable to vest the unlisted securities unit with power, now obtaining in respect of applications for extension of unlisted trading privileges, to participate in decisions on all applications for termination of such privileges and all applications for withdrawal of listed securities. In both these latter types of cases, the unit now prepares analyses and recommendations; in both, and especially in the extension or termination of unlisted privileges, the issues are highly technical, involving questions of detailed mechanics of trading, and requiring the judgment of specialists and not of the jack-of-all trades which the interpretative section must necessarily tend to become; in both, the contest, if there is any, is ordinarily between outside persons and the Commission is not involved therein at all; and in neither is there

any question of proceeding against or discipling any one or any other emotional issues which may tend to prevent a wholly fair and calm judgment.

In the "Uncontested" and other cases whose post-hearing phases are handled by units or divisions other than the interpretative section, no digests are ordinarily prepared for the Commission and no oral report is made (except in complicated cases under the Holding Company Act) prior to the submission of the draft opinion and order. Only if the Commission has some question arising out of the draft is there likely to be an oral presentation to the Commission and discussion between it and the staff.

The procedure in respect of "contested" cases assigned to the interpretative section is considerably more elaborate. Under a recently instituted practice, the opinion attorney prepares a lengthy and impartial digest of the record. In its preparation, he has no right of selection, but must include all matters adduced at the hearing. Meanwhile, immediately after the oral argument (there is no report by the opinion attorney prior to such argument), and upon the basis thereof and of the briefs, the Commission adjourns to executive session and discusses the issues among its members. A few days later, at least in difficult cases, the commissioners again take

up the case, call in the opinion attorney and his supervisor and block out the opinion to them. The digest of evidence, it is to be noted, has ordinarily not yet been presented to the Commission. The opinion attorney, in turn, continues to prepare his digest, and drafts the opinion as outlined by the Commission. When the digest, which contains page references and is indexed, and the draft whose findings are numbered by line to facilitate discussion, have been completed, they are submitted to the supervising attorney, who reads them carefully, reads parts of the record, the briefs and the trial examiner's report, and in conjunction with the opinion attorney, often revises the draft. When the draft is finally shaped by the opinion attorney and his supervisor, it is then submitted to the Assistant General Counsel in charge of the section (and occasionally, in difficult cases, to the General Counsel) and, upon his approval, both the digest and the draft are circulated among the Commissioners. After the commissioners have familiarized themselves with the digest (and it is confidently asserted that at least some of the Commissioners read every page of the sometimes many hundred-paged digests) and the draft, the opinion attorney and the supervising attorney are called in for conference. At this point, the case is fully explored and the discussion is searching; in most

cases, according to an address by the Commission's General Counsel, "the opinion is not acceptable in its first draft and must be rewritten in accordance with the matured conclusions of the Commission. Occasionally a completely new opinion, or even alternative opinions, must be prepared."

While it is unquestionable that the Commission's present post hearing procedure is so devised as to provide for a maximum of consideration by the Commission itself, some doubts may arise whether the digests are entirely useful. They are so complete, unedited, and unabridged that there is some question, even in the minds of those who prepare them, whether it would not be almost as easy and expeditious for the commissioners to read the record. While such complete digests avoid the danger of "canned" presentations of facts, their very length may defeat the beneficial purposes for which they were intended. And if such digests - or any other forms of analysis of the record by subordinates are to be used - it would seem to be more logical that the analysis should be presented to the Commission before rather than after it has already given its instructions concerning the opinion it wishes to be prepared. Under the present

order of the steps, the Commission, or the attorney, or both, must either proceed blindly with the outline of an opinion — the Commission blindly because it has not yet had the facts before it, the attorney because he has had no full discussion of the case with the Commission; or if they do not so proceed blindly, the digest is not really necessary. In fact, it may be observed that the latter alternative is the more likely one: The briefs, which the Commission has read before the oral argument, contain fairly complete statements of fact which are at least sufficient for it to outline its general views; further factual presentation is necessary only in the comparatively rare case of conflict, and even then, it seems probable that only limited areas need be covered by a report of the testimony.

It may be emphasized again that, in the course of its preparation of the digest and the draft, the interpretative section is ordinarily completely insulated. In this connection, the Assistant General Counsel in charge of the section has issued a memorandum (August 18, 1933) to that section, stating:

"In no cases assigned for the preparation of opinions should the attorneys confer with the attorneys who have been responsible for the preparation or prosecution of the proceedings. ... It is just as improper to consult employees of the Commission who have taken part in the

proceedings as it would be to consult attorneys for the respondent. Even on formal or procedural matters not concerned with the merits of the case, attorneys should consult the supervising attorney and allow him to make any inquiries from other divisions of the Commission which may be necessary. The same inflexible rule must apply to consultation with the trial examiner."

It is the practice of the interpretative section to submit all accounting problems arising in the course of the decision of any case to the Commission's Chief Accountant for discussion and conference; in addition, the opinion writers may from time to time consult other Commission experts on technical problems. In no case, however, are they persons who have participated in the preparation of the case or testified at the hearing. In a few isolated and special instances, however, this complete segregation has been wisely suspended and in particular cases or situations where a problem of policy which cuts across the individual case arises, and the decision will affect the general administration of the division concerned, discussion between the division which prepared the case and the interpretative section may be allowed. Thus, for example, in one of the early cases involving an application for a withdrawal of a registration statement, a matter of important policy was involved and the registration division was consulted; similarly,

in utility cases where there are controversies . merely of law or policy, the Public Utilities Division may confer with the interpretative section. Such cases do not involve questions of fact at all; and it is said that in so far as possible, the conferences are kept on a general basis without specific reference to the case involved. Finally, a further departure from the strict policy of segregation lies in the practice, already described, of submission by the unlisted securities unit and, occasionally, by the over-the-counter unit of memoranda to the Commission, which, in turn, may transmit them to the interpretative section. Ordinarily, such memoranda are brief and factual; in one recent case, however, the over-the-counter unit submitted a memorandum prepared by one of its staff who had not participated in the case which, in effect, was a draft opinion. This memorandum, in fact, was so complete that the interpretative section, after analyzing the record and discussing the case with the Commission, adopted it as its draft; it is interesting to note that this draft, prepared and ultimately approved by the Commission, was a broker-dealer registration case in which the Commission (following the draft) found that grounds existed for revocation, but found that revocation would not be in the public interest or for the

protection of investors. The respondent was thus  
apparently not prejudiced by this departure from  
the strict theory of segregation.

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182. The draft or tentative opinions are not ordinarily submitted to the parties prior to their adoption by the Commission. In one case under the Holding Company Act, even though there was a trial examiner's report, the tentative draft of the final opinion was submitted to the parties. This was because there were 43 requests for oral argument and the Commission felt that many of the requests would be abandoned and the issues would be greatly narrowed if the draft were circulated. Further, in those cases where there is a complete departure from the trial examiner's report, and the Commission embarks upon a new theory of which the parties had no effective notice, the draft will be submitted to the parties as a proposed decision upon which argument may be had.

In addition, an informal type of tentative draft is utilized in Holding Company Act cases where there has been no report, but where after the hearing and in the course of conferences with the Commission, a position different from that originally taken by the Utilities Division in its earlier conferences with the utilities develops, or new conditions not theretofore discussed are contemplated. Such new views are forthwith informally communicated to the applicant or declarant, and if the latter does not acquiesce, is afforded an opportunity for oral argument and the filing of briefs. Even in such cases where the applicant does not acquiesce, the final opinion may be drafted by the Utilities Division members who participated in the proceeding.



The decision. The final orders of the

Commission are accompanied by written opinions which must be considered and approved at meetings of the Commission, at which at least a quorum of the Commission is present. <sup>183</sup> In simple and uncontested cases

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183. The following interlocutory, subsidiary, or other orders are not accompanied by an opinion and are not necessarily considered by the entire Commission: (a) orders granting applications for the filing of pre-effective amendments under Section 8(a) of the '33 Act (one commissioner); (b) temporary suspension orders against oil and gas offering sheets under Regulation B (Chief of the Oil and Gas Unit); (c) orders declaring post-effective amendments effective under Section 8(c) of '33 Act (Director or Assistant Directors of the Registration Division); (d) orders granting applications for confidential treatment of contracts under '33 Act, and denying such applications where no hearing is requested (one commissioner); (e) orders consenting to withdrawal of registration statement under the '33 Act (Assistant Director of Registration Division); (f) orders granting or refusals to grant applications for acceleration of the effective date of a registration statement for a security under the '34 Act (formerly one commissioner, now full commission); (g) notices of deficiency suspending the effectiveness of registration of an unissued warrant or other security for "when issued" trading under Rule X-12D3-1 (Director or Assistant Director of Registration Division); (h) orders granting or denying the application of an exchange for the continuation of unlisted trading privileges for a security undergoing change under Rule X-12F-2 (one commissioner, except in doubtful cases); (i) decisions (not in the form of orders) granting or denying applications for acceleration of the effective date of a broker-dealer registration (supervising attorney in Trading and Exchange Division); (j) orders deferring for 15 days the effective date of a broker-dealer registration (one commissioner); and (k) orders granting, or if no request for hearing, denying applications for confidential treatment under the '34 Act (one commissioner, except in doubtful cases.) (Continued)

the opinion is short, recites the facts in bare form, and concludes with the order. In other cases, elaborate, well-reasoned opinions are written; in general, they are admirably articulate and serve as excellent guides to the rationale of the several types of cases handled by the Commission. In addition, one should note with appreciation the Commission's practice of preparing and issuing opinions on procedural matters - a policy too rare among administrative agencies. It is submitted that, in general, the Commission's practice in respect of its written opinions serves as a healthy safeguard against ill-considered or arbitrary actions and is a useful method of assuring a continually developing collection of law in the field.

In like manner, the Commission has been keenly aware of the precedent power of its decisions, and has utilized and consistently sought to apply the doctrine

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183. (Cont'd)

Recently the Commission has added to this list orders granting applications for the striking or withdrawal of a security from listing and registration under Section 12(d) where the issues are not new, the precedent clear, and no controversy exists. The order, except in controversial cases, is upon the recommendation of a single commissioner. It should be noted that the Commission has no power to deny such applications shown to have been made in accordance with the rules of the exchange, and has only the power to fix terms and conditions necessary for the protection of investors. In the Matter of Allen Industries, Inc., 2 SEC 14 (1937). In addition, no findings and opinions necessarily follow hearings on applications for confidential treatment under the '33 Act; in about ten cases on such applications under the '34 Act (where the issues are more complex) findings and opinions were prepared but were not, of course, made public.

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of stare decisis. Nevertheless, the Commission has occasionally, and properly reversed itself; as stated by the present Chairman (Address by the Association of the Bar of the City of New York, May 5, 1939):

"Experience with the operations, in actual practice, of the past decisions of the SEC sometimes teaches us that, in past decisions, we erred. Study sometimes demonstrates that we made a mistake in our last year's order concerning Company A. In that event, we should not, because of veneration of our own error, or a mechanical application of logic, perpetuate our earlier mistake, but should, and we do, decide somewhat differently the case of Company B on the basis of our intervening educative experience . . . [An administrative agency] must not hamstring business activities by wooden and inflexible adherence to its own precedents when experience shows them to be wrong."

And, it is to be noted, where the Commission in fact overrules prior decisions, it usually gives ample warning. Thus, in In the Matter of Virginia Public Service Co., 4 SEC (1939), an application under the Holding

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184. "In practice, the authority of its own decided cases is so clearly recognized by the Commission that adherence to the doctrine becomes an accepted fact." Frequent use of citations mark Commission opinions and "opinions relying on the authority of the Commission's prior decisions far outnumber those lacking such references." Stare Decisis in N.L.R.B. and SEC (1939) 16 N.Y.U.L.Q. 618, 624-630.

Company Act to issue and sell, and acquire, securities and lease assets in the course of an expansion program was involved. Speed was essential, and the applicant had made considerable preparation for the consummation of the transaction. A short time previously, a similar application by a different company had been approved. Accordingly, the Commission granted the application in the instant case, stating, "We are . . . reluctant to deny this applicant, who may have acted in reliance upon our earlier decision, the same treatment as was accorded the [applicant in the prior case]. Accordingly, we will not enter adverse findings here, but will not necessarily regard the [prior] decision as a precedent for the future."<sup>185</sup>

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Rehearing. Rule XII(d) of the Commission's

Rules of Practice provides that "Any petition for re-

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185. Cf., In the Matter of Columbia Gas & Electric Corp., 4 SEC 406 (1939). It is customary for the Commission to give advance warnings of a change in policy.

186. Problems of res adjudicata and estoppel by judgment rarely arise in Commission cases. The acceleration of pre-effective amendments to a registration statement is "simply the performance of an administrative function. . . . It [is] . . . not . . . a quasi-judicial determination that the registration statement was free from deficiencies" and so does not estop the Commission from bringing subsequent stop order proceedings. In the Matter of Breeze Corporations, Inc., 3 SEC 709, 732 (1938); cf., In the Matter of Bankers Union Life Co., 2 SEC 63 (1937). The question of whether or not a finding in a stop order proceeding under the '33 Act that a registration statement contains a material misstatement

(Continued)

hearing shall be filed within 5 days after the issuance of the order complained of and shall clearly state the specific grounds and the specific matters upon which rehearing is sought." Strict application of the time limit in this rule may be waived by the Commission; but, in general, such petitions for rehearing are rare. So far as can be ascertained, only three petitions have been received. One was denied, two were granted. Of the latter two, the requested modification, which followed oral argument, was granted in one, <sup>187</sup> and granted in part and denied in part in the other. Finally, in one case, In the Matter of Consumers Power Co., et al., Holding Company Act Release No. 1854, December 28, 1939, because the problems were highly controversial and complex, the application had been filed late so that the

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186. (Cont'd) by the underwriter who is party to the proceeding is res adjudicata on that issue in a case brought to revoke the underwriter's broker-dealer registration for wilful violation of the '33 Act, has never been squarely raised; but this would seem an appropriate situation in which to invoke the doctrine of res adjudicata. Cf., In the Matter of Sweet's Steel Co., 4 SEC (1939). Similarly, court injunctions and convictions with respect to the fraudulent sale of securities are grounds for the revocation of a broker-dealer registration. Thus, a broker or dealer against whom the Commission has successfully proceeded in court may later in the revocation case be estopped from questioning the correctness of the court decree, although he may introduce evidence in respect of the issue whether revocation would be in the public interest or for the protection of investors.

187. In the Matter of National Educators Mutual Association, Inc., Petition of B. I. Dahlberg, 1 SEC 279 (1936).  
(Continued)

issues were somewhat hastily litigated, and the decision was adverse, involving the application of new principles, the Commission announced in its opinion and at its own instance that . . . "we shall, upon request of any of the parties made within five days, grant, as a matter of right, a rehearing . . . And if any of the parties so request, we shall reopen the record so that an opportunity may be afforded to present any further evidence which might require different findings . . . " Although considerable adverse publicity attended the majority opinion in this case, the Commission's offer to allow a rehearing as a matter of right was not accepted by any of the parties.

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187. (Cont'd) In a previous decision involving a stop order, the Commission had included some comments severely reflecting upon the registrant's accountant, who had not participated in the hearing. The accountant petitioned for a modification and revision in respect of these comments. Oral argument was permitted and the modification was made.

Procedure under the Maloney Act. Under the Maloney Act (Section 15 A of the Exchange Act) the Commission performs the novel function of an administrative body's exercising reviewing powers over the judicial functions of a private organization - a national securities association. Although only one national securities association has thus far been formed, and that very recently, and only one case (In the Matter of Sisto) has come before the Commission and is still awaiting final determination, the Maloney Act itself, the rules of the securities association, and the Sisto case block out the procedure for the Commission's performance of this function. Section 15 A (b) (8) provides that, to be registered as a national securities association, an association of brokers and dealers must have rules which provide that its members should be appropriately disciplined by expulsion, suspension, fine, censure, or any other fitting penalty, for any violation of its rules. Further, Section 15 A (b) (4) requires that the association's rules must provide that, except with the approval or at the direction of the Commission, no broker or dealer shall be admitted to or continued in membership of such association if (a) he has been suspended or expelled from a registered securities association or from a

national securities exchange, for violation of certain types of rules; or (b) is subject to a Commission order denying or revoking his registration or suspending him from an association or exchange.

Section 15 A (g) provides that if any registered securities association shall take any disciplinary action against any member, or shall deny admission to any broker or dealer seeking membership therein, such action shall be subject to review by the Commission, on its own motion, or upon application by any person aggrieved thereby filed within sixty days after such action has been taken. Application for review, or institution of review by the Commission on its own motion, operates as a stay of such action. The Commission is required by Section 15 A (h) (1) to give appropriate notice and opportunity for hearing in a proceeding to review disciplinary action taken by an association, and upon consideration of the record before the association and such other evidence as it may deem relevant, may affirm, modify, or dismiss. After appropriate notice and opportunity for hearing the Commission may also cancel, reduce, or require the remission of a penalty imposed by the association, while under Section 15 A (h) (3), after appropriate notice and opportunity for hearing in any proceeding



to review the denial of membership in a registered securities association, and upon the record before the association and such other evidence as it may deem relevant, the Commission may dismiss the appeal or require the association to admit the appellant to membership.

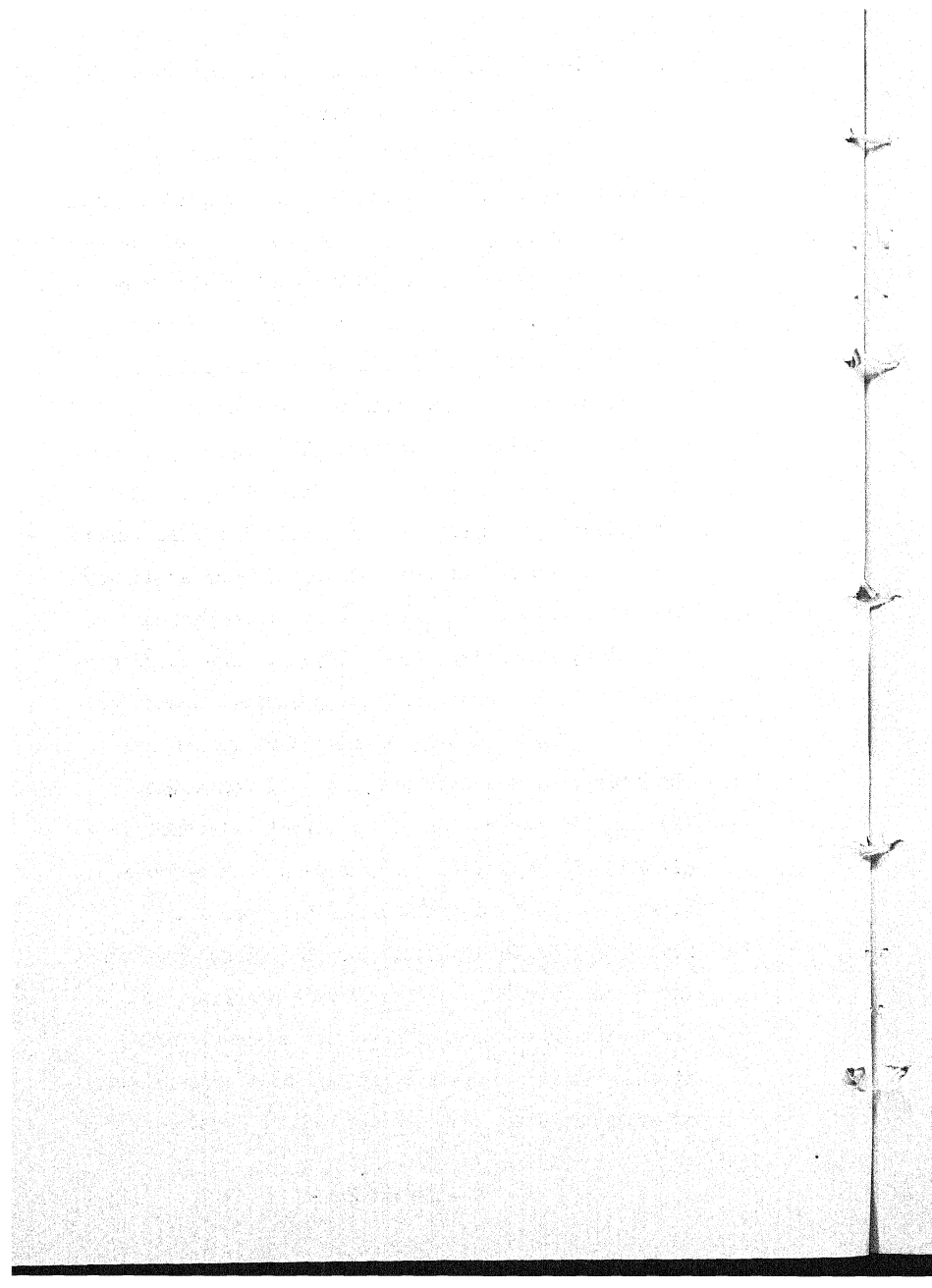
Section 15 A (b) (9) requires certain basic procedures to be followed by the association: Its rules must provide for a fair and orderly procedure with respect to the disciplining of members and the denial of membership; in disciplinary proceedings, specific charges must be brought; the member must be notified of such charges and must be given an opportunity to defend against such charges; and a record must be kept; and the association's determination must be accompanied by certain specific statements of the charges, the grounds of action and the like. Similarly, in respect of denial of membership, there must be notice and opportunity for hearing, a record must be kept, and the specific grounds of denial must accompany the determination.

In accordance with these requirements, the National Association of Securities Dealers, Inc., has promulgated an admirable "Code of Procedure for Handling Trade Practice Complaints". Fourteen District Business Conduct Committees and the Board of

ing. After hearing or default, a written decision must be prepared by the Committee.

If the Committee shall take any disciplinary action or shall dismiss the complaint, such action is subject to review by the Board of Governors on its motion within 60 days after the Committee has notified it of such action; in addition, any person aggrieved by the action may file an application for review within 30 days. Review operates as a stay of action. The Board of Governors shall give appropriate notice and opportunity for review, and upon the basis of the record before the Committee and of such other evidence as it may deem relevant, shall enter a written decision affirming, reversing, or modifying. The Board may also remand the case to the appropriate Committee.

Thus, it will be seen that in general the course of the case shall be (1) complaint; (2) hearing before the association's District Committee; (3) appeal to and review by the association's Board of Governors; and (4) appeal to and review by the Commission. But the first case arising under the Act presented novel problems. The broker had been expelled from an exchange under circumstances which made the association's denial of membership to him necessary under Section



15 A (b) (4) (A). The exchange's procedure had not contemplated the right of counsel, cross-examination, or other formalities, although there was a record and a hearing. Without resorting to the procedure prescribed by its rules, apparently since they were deemed to be inapplicable because under the Maloney Act it was required to do so, the association forthwith denied membership to the broker without a hearing. Thereafter, the broker brought the case before the Commission not by way of petition for review, but through an "application for approval of an application for membership, or for an order directing the National Association of Securities Dealers to admit applicant for membership". Thus the case was contemplated as an original action; and, indeed, under the wording of Section 15 A (b) (4), this conclusion seems to be impelled, since the association must deny membership, and the only discretion rests in the Commission whether the rule requiring such refusal or denial shall be suspended in the particular case. In short, Section 15 A (b) (4) envisages a proceeding de novo, since there is no hearing or record made before the association upon which review could be based. But Section 15 A (h) (3), seems to be in conflict with Section 15 A (b) (4), because, as

already described, the former refers to proceedings to review the denial of membership, and permits the Commission to reach its decision upon the record before the association. Section 15 A (h) (3), therefore, seems to envisage a procedure more in the nature of an appeal and review. Finally still another problem arose in respect of the scope and nature of the Commission's functions in the premises: Since the exchange's expulsion procedure is rather informal, there is no record upon which it can act in an appellate capacity, nor, as already noted, was there a record or hearing before the association. Accordingly, the Commission is faced with the apparent necessity, in a case arising as did the Sisto case, of trying the matter de novo and exploring the issue as to whether the broker or dealer had been properly expelled by the exchange.

This was the policy adopted by the Commission in the Sisto case; it was treated virtually as an original procedure. Notice was given to the broker, the association, and the chairman of its district committee, and the hearing was held before a trial examiner; the Commission participated through its counsel, although the association announced itself as "neutral" and did not participate. The surrounding circumstances of the broker's

expulsion and of his alleged violations of the exchange's rules were explored. The applicant produced his own case first; thereafter Commission counsel called his witnesses. The counsel for both parties announced that they did not consider the proceedings "adversary", and the Commission counsel stated that "My purpose in this proceeding is to place in to the record whatever evidence I have been able to find bearing on the point as to whether it would or would not be in the public interest for the Commission to render an order directing . . . the association to admit . . . Sisto. In doing so I feel it is my function to present evidence of any kind, whether it be favorable or unfavorable to the applicant, and if there is any contradictory testimony, to arrive at the truth." Nevertheless, when a witness called by the Commission counsel testified favorably to the broker, the former claimed surprise and the right to treat the latter as a hostile witness.

At the conclusion of the hearing, the trial examiner issued his report containing findings of fact only; both the Commission counsel and the applicant's counsel excepted thereto after having submitted requested findings. Thereafter, oral argument was held before the Commission, with

both counsel participating, and with the broker's counsel having the right to open and close. At this argument, it is to be noted, Commission counsel acted as an advocate rather than a neutral, and contended vigorously that the Commission should not permit the broker to become a member of the association. After the hearing, the case was assigned to the interpretive section for analysis of the record and preparation of the decision.

### III.

#### Rule-Making

Issuance of rules and regulations. A major function of the Commission, and indeed, one closely related in many respects to its adjudicatory activities with which there is considerable interplay,<sup>188</sup> is the issuance of rules and regulations.<sup>189</sup> The regulations authorized by the Acts and issued by the Commission vary widely in their nature, from those which prescribe methods of business and trade activity to the most minute specification of the means whereby information is to be presented in a form, application, or report. Roughly, and for purposes of convenience, the regulations may be divided into three general categories: (A) Substantive implementing rules, including exemptions and regulatory rules; (B) adjective implementing rules, prescribing forms, special instructions and procedures; and (C) interpretative or definitional rules.

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188. Where feasible the general principles are, as a rule, blocked out by rules and regulations, to be supplemented by the case decision method. In many instances, of course, the regulations can serve to state the guiding principles only in general terms (e.g., the rule concerning stabilizing); implementation is by individual cases. Conversely, principles established by, and situations arising in, individual cases may form the basis of regulations.

189. For a complete compilation of the powers to issue rules and regulations vested in the Commission by the three Acts, see Appendix B, pp. 317-328.



(A) Substantive implementing rules. 1. Exemptions. Pursuant to the several Acts, the Commission is authorized to add to the exemptions already provided by statute still further exemptions of certain types of securities and transactions from the operation of one or more particular provisions of the Acts; in addition, it may attach conditions to such exemptions. Thus, for example, Section 3(b) of the '33 Act provides that the Commission "may from time to time by its rules and regulations . . . add any class of securities to the securities exempted as provided in this section, if it finds that the enforcement of this title with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection where the aggregate amount at which such issue is offered to the public exceeds \$100,000." Under this subsection, the Commission has issued Regulation A, Rules 200 to 210, exempting certain securities other than those relating to oil and gas interests, Regulation B, Rules 300 to 356, exempting certain fractional undivided interests in oil or gas rights, and Regulation B-T, Rules 360 to 396, exempting certain interests in oil royalty or similar types of trusts. In like manner, the Exchange Act (under which the powers of exemption are considerably broader) permits the Commission to exempt certain securities for all purposes (e.g., Rule X-3A12-2) from some specified sections of the Act - such as registration (e.g.,

Rule X12A-1 to X-12A-9, inclusive); and to exempt from civil liability certain transactions of insiders (e.g., Rules X-16B-1 to X-16B-3). Finally, under the Holding Company Act, the Commission may exempt, and has exempted, various types of holding companies, subsidiaries, banks, brokers, dealers, and other persons or classes of persons from one or more obligations and duties imposed by the Act, or it may exempt specified types of transactions. It should be noted that in respect of exemptions under this Act, there is a choice between exemptions by regulations and by the case method: In general, the regulation outlines the conditions under which exemption applies, and leaves border-line questions and details to be filled in by determinations upon applications filed.

2. Regulatory rules are, in general, designed to impose substantive restrictions on the activities of particular groups or businesses, or to impose substantive duties upon members of such groups or persons engaged in such businesses. The Securities Act, however, has vested the Commission with no powers to issue regulations of this type: The substantive restrictions and duties are imposed by the Act itself which has not left to the Commission any power to impose additional restrictions or duties (except in so far as it may impose substantive conditions upon exemptions). In contrast, various sections of the Exchange Act empower the Commission to prescribe rules and regulations necessary or appropriate in the public interest or for the protection of investors, acts or

transactions in contravention of which are prohibited by the Act. Thus under such provisions there is no automatic prohibition of the acts or transactions specified, since nothing is prohibited until the Commission adopts rules in respect of them. Typical of these provisions are those applying to pegging, fixing, or stabilizing the prices of securities on national securities exchanges (Rules X-9A6-1 to X-9A6-6); to short-selling of registered securities (Rules X-10A-1 and X-10A-2); and to solicitation of proxies (Regulation X-14). In each of these types of transactions, the Commission must issue regulations before the prohibitions become operative. Similar provisions are to be found under the Holding Company Act, which, for example, prohibits solicitation of consents or proxies, extensions of credit, transactions with affiliates, and the like, in contravention of regulations of the Commission.

B. Adjective implementing rules include rules prescribing the form and detail in which information, documents, and reports are to be prepared and filed in registration statements, applications, and declarations and prescribing the procedures to be followed in connection therewith. Each of the Acts contains authority to issue rules of this character; their general nature has been described in passing in Part II of this monograph, especially at pp. 226-228.

C. Interpretative rules. Section 19(a) of the '33 Act, Section 3(b) of the '34 Act, and Section 20(a) of the Holding Company Act each empowers the Commission to define accounting, technical, and trade terms used in those Acts. Under these sections,

the Commission has adopted General Rules and Regulations, Rules 140 to 153 ('33 Act), Rules X-3B-1 to X-3B-3 ('34 Act), and Rule U-17C-3 (Holding Company Act). In addition, the Commission has adopted rules defining the meaning of terms in its own regulations, forms and instructions.

Finally, it is to be observed that the Commission has adopted general rules of practice for the conduct of its hearings, as well as rules in respect of internal administration. The former have been adverted to in Part II of this monograph; the latter treat of such subjects as non-disclosure by employees of information obtained in the course of investigations and examinations, employees' security transactions, office hours, and the like.

Until about a year ago, there existed a Forms and Regulations Division in the Commission; it was charged with the functions of drafting regulations and forms. After a relatively mature development of forms and regulations under the first two Acts had been achieved, the Division was abolished because it was considered unnecessary to be maintained simply for purposes of revision. There remain, however, a Forms and Regulations Unit in the Registration Division, and one in the Public Utilities Division, both of which work, generally, on the problem of improving, interpreting and coordinating forms and regulations in their respective spheres. At present, each of the several divisions is charged with the duty of considering and initially

drafting recommendations in respect of regulations applicable to it. Such drafts are ordinarily examined by the General Counsel's office; the Commission issues the final regulation after giving its own consideration, usually detailed, to the problems involved.

Procedure leading to formulation of rules and regulations. The wide variety of the rules and regulations issued, the multitude of particular situations which must be treated, and the technical nature of much of the subject-matter, all combine to necessitate the Commission's following an ad hoc procedure in respect of each regulation, or each type of regulation, which comes before it. As will be noted from the description which follows, some of the regulations must be preceded by months and sometimes years of study; some, on the other hand, must be drafted and promulgated almost immediately to meet the exigencies of a particular occasion. Of necessity, flexibility is a chief characteristic of the Commission's procedure in respect of the issuance of its regulations.

In general, the investigative and consultative techniques are utilized; the Commission has never resorted to formal hearings prior to the issuance of rules and regulations. Both the Exchange

190. The Exchange Act requires notice and opportunity for hearing before the Commission may abrogate, alter, or supplement the rules of a registered securities association or may adopt any rule, regulation, or order supplementing the rules of a national securities exchange. In both cases, however, the Act expressly permits and requires that the Commission first request the exchange or association to make such changes in its rules. Accordingly, the Commission's powers over such rules have been exercised through conferences with the exchange or the association; no hearings have been held.

Act, through Section 21(a), and the Holding Company Act, by virtue of Section 18(a), expressly authorize the Commission to make formal investigations of the type described supra, pp. 96-97, to inquire into facts, conditions, practices and matters which it may deem necessary or proper to aid in the prescribing of rules and regulations under these two Acts. One such investigation was held after the Richard Whitney failure; one of the purposes of the hearing was stated in the notice to be ". . . to aid . . . in the prescribing of rules and regulations pursuant to Sections 8(b) and (c), 11(a), 16(a), 17(a), 19(b)(1), (6), (7), and (13) and other pertinent provisions of" the Exchange Act. Following the investigation, Rules X-17A-3 and X-17A-4 were promulgated; others were drafted and are now the subject of circulation for comment among the persons and businesses proposed to be affected. In addition to formal investigations involving hearings, the Commission, of course, engages in intensive informal studies and investigations of the subject-matters concerning which regulations may be issued. Thus, as described above (p. 101), a field study was made by members of the Commission staff concerning conditions and practices in respect of disclosure of gross sales and cost of goods sold, and other data by businesses. Such a study led to changes in the Commission's forms and new regulations relating to the policies in respect of confidential treatment.

The consultative process, however, is the one most frequently utilized by the Commission. Under the Securities Act, that process

has been uniformly utilized in the promulgation of forms and regulations; similarly, it has been used in respect of forms and regulations for the registration of securities under the Exchange Act. In the early history of the Commission, when the basic forms and regulations had to be devised, various committees for cooperation were formed by outside groups; drafts were sent them for criticism and advice; and both the staff and the Commission itself frequently consulted with such groups. Such committees included the representatives of those persons concerned. They were formed by the American Institute of Accountants, the Comptrollers' Institute of America, the Investment Bankers Association and the several exchanges. In addition, in respect of forms for investment trusts and insurance companies, committees of executives and lawyers representing those industries, and representatives of State insurance commissions were consulted. With regard to forms and regulations concerning oil and gas matters, there were conferences with representatives of Eastern States Association of Dealers in Oil and Gas Rights, Midcontinent Royalty Dealers Association, and active dealers in the businesses affected. In mining matters, consultation was had with the American Mining Congress and numerous individual concerns.

In respect of most of the rules of a regulatory nature, issued under the Exchange Act, the same process has been utilized; in some instances, conferences and consultations were, for special reasons, omitted. Thus the original regulations dealing with

short-selling were promulgated after three years' study of market operations, and after announcement that they would be issued, but without consultation. This was due largely to tactical reasons. It came in the midst of a breakdown in the hoped-for cooperation between the Commission and certain exchanges over the question of reorganization of such exchanges. The issuance of the rules is credited with having aided in the achievement of greater cooperation between the exchanges and the Commission and, subsequently, upon the recommendation of the New York Stock Exchange and after conferences with its officers, the rules were modified.<sup>191</sup> So far as is recalled, the only other instance in which the consultative process was omitted prior to the issuance of regulatory rules under the Exchange Act, was that dealing with transactions in respect of unlisted securities traded over-the-counter (Rule X-10B-4). The Commission believed that its rule was simply declaratory of Section 17(a) of the Securities Act, which prohibited the use of fraudulent devices and schemes, and that the rule served only to call attention to the fact that the section applied to trading practices outside the exchanges. The issuance of the rule, however, immediately provoked such opposition from various groups who claimed that Section 9(a) of the Exchange Act, prohibiting manipulation, could not be applied to over-the-counter business, that the rule

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191. See Fourth Annual Report, pp. 87-88; Fifth Annual Report, pp. 44-45.



was withdrawn in so far as it related to over-the-counter operations, the Commission has since relied on Section 17(a) of the Securities Act and it is doubtful whether any substantive changes occurred in the course of the episode. Hindsight, if nothing else, would seem to lead to the conclusion that in respect of regulatory rules, submission to outsiders is desirable in all cases where time is not of the essence. In this particular instance, although there might have been little difference in the ultimate actual result, such submission would have informed the Commission of the reactions in advance and some friction and embarrassment would probably have been eliminated.

The consultative process has not been uniformly used in respect of rules and regulations under the Holding Company Act, where the subject matter is considerably more dynamic and the various rules may require particularization in terms of the needs of individual situations and transactions. Owing to the injunction suits filed against the Commission on or before December 1, 1935, the date prescribed by the Act for the registration of holding companies, the first regulations issued under the Act were not regulatory but rather pertained to exemptions and to procedures for filing applications therefor and for filing preliminary notifications of registration. At an early date the controlling companies of the several utility systems and leading associations of accountants established committees who worked with the Commission and to which such rules of general interest were

submitted. Exemption rules which had limited applicability, often in respect of a particular situation or transaction, were not generally circulated; but ordinarily they were prepared at the request of and in conjunction with the persons directly interested, and they were such that immediate issuance was necessary in order to avoid injury to the private rights affected. It is to be noted in this connection that, in any event, the utility field is not so highly competitive that persons other than those directly affected by particular exemptions are likely to be interested therein. For the most part, rules and forms of substantial importance issued under the Act have since been submitted to the industry and have been subject to the process of consultation and conference. Thus, for example, the draft of the form prescribing the complete registration statements to be filed by registered holding companies was submitted to the industry for comment.<sup>192</sup> Similarly the rules relating to the uniform systems of accounts were submitted to and extensively

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192. Submission is accompanied by letters, typical of which is the following:

"September 14, 1936

Dear Sir:

Enclosed are copies of a draft of a form USB to be prescribed for complete registration statements to be filed by registered holding companies...

...

This is a purely tentative draft which we are submitting to the representatives of the industry for their comment. Owing to the preliminary nature of this draft (cont'd)

discussed with representatives of the industry as well as a special committee of experts on public utility accounting appointed by the American Institute of Accountants; so, too, rules relating to service companies, interlocking directorates, and representatives of utility interests were submitted to the industry. The rules relating to interlocking directorates submitted to leading banks and bankers associations while those dealing with representatives of utilities were also submitted to special committees of the American Institute of Consulting Engineers, Inc., and the American Institute of Accountants.<sup>193</sup>

Certain classes of rules under the Holding Company Act, however, were not preceded by consultations or conference. Typical of such a class is that which includes those rules requiring applications and declarations, and prescribing the procedures therefor. In such cases, regulation is exercised by order in the

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192. (continued)

you are requested to treat it as confidential, but of course there is no objection to your discussing it with any of your associates whose views you think would be helpful.

Inasmuch as it is hoped that this form will be promulgated around **October 1** in order to allow approximately two months for completion and submission, I would greatly appreciate receiving by September 23, any suggestions you wish to make.

...

Chairman"

193. The requests for comment and suggestion may sometimes include considerable explanation and discussion of the specific points involved. For a typical letter of this nature, see Appendix D, pp. 338-340. And the proposed rule may even be accompanied by an articulated and reasoned dissent prepared by one of the commissioners.

particular case rather than automatically by the impact of the rule itself. In some cases of this nature the Commission has deemed it inadvisable to submit a rule to the industry because of the danger that certain companies might take advantage of the interim period to effect transactions which the rule is designed to regulate and thus escape the intended regulation of the conduct altogether.<sup>194</sup> Accordingly, the Commission will forthwith issue a rule prescribing that applications, containing specified information, for approval of such transactions must be filed and hearing held thereon. It is inevitable that in issuing a blanket rule of this nature, prescribing applications for all transactions of a particular type, the rule will apply to minor transactions which are on their face legitimate and desirable and for which, accordingly, the machinery of application and hearing is unnecessary. But it is doubtful whether consultation or any other procedure would permit of an effective

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194. That this is not an imaginary factor born of undue suspicion is indicated by the circumstances surrounding the issuance of Rule U-12 C-3, which required applications before a holding company or subsidiary could "make any payment of principal or interest on any note, bond, book account or any indebtedness...which is or was issued as, or based upon a dividend...created or issued or declared from, or charged against capital or unearned surplus..." Prompt issuance was necessary since there had come to the attention of the Commission the fact that a company in financial difficulties was contemplating large payments of interest on a note which had been previously issued to its parent holding company in place of cash payment of a dividend declared out of capital surplus (which, in turn, is prescribed by Rule U-12 C-2). Upstream payments of this sort were deemed to circumvent Sec. 12(c) and Rule U-12 C-2 and in this particular case, would have done considerable injury to the public and to investors. Delay for submission to the industry would have given the company ample warning and time to consummate the transaction and place it out of the reach of regulation. See In the Matter of Associated Gas and Electric Corporation, 5 SEC (1940), H.C.A. Release No. 1873.

rule which, at the outset, could take into account all such transactions where hearing and application could properly be dispensed with. In cases of this sort, when the course of experience begins to develop recognizable patterns, the rule can be amended and continuously shaped to meet the practical situations and, as time goes on, such rules can be, and are, vested with more and more specificity.<sup>195</sup>

It is at this point where the impact of Commission hearings in particular cases occurs in shaping the regulations. Thus in In the Matter of West Penn Power Co., 3 SEC 774 (1938), one of the issues in the case, arising upon a declaration in respect of the issuance and sale of securities, was the size of the finder's fee proposed to be paid to the affiliated finder. The Commission stated that the fee was large, and ought not be paid; but the only way payment could be prevented was to refuse, under Sec. 7(d) (4), to permit the declaration to become effective, thus preventing the entire transaction. This the Commission felt was too drastic a step to take without warning; accordingly it did not find the fee unreasonable but immediately instructed the staff to draft a rule relating to affiliated finders and underwriters in the future. As a result, Rule

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195. See for example, the progressive development of Rule U-93-3, relating to the acquisition of securities, originally issued in 1935, and amended June 5, 1936 (Release No. 232), February 23, 1937 (Release No. 549), September 1, 1937 (Release No. 809), October 5, 1937 (Release No. 834), December 9, 1938 (Release No. 1349), and July 17, 1939 (Release No. 1734).

Quite naturally, the time element in the course of the process leading to the promulgation of a rule varies. Normally, where the proposed rules are submitted to the industry, ten days or two weeks are specified for reply; replies received thereafter are, however, considered. As described by a former Chairman of the Commission,<sup>197</sup>

"I have seen as little as twenty minutes elapse between the drafting and promulgation of a permissive rule where the exigencies of the situation called for quick action. On the other hand, I have watched and participated with the experts for over two years in a vain attempt to find a solution to a problem which continues to defy even a tentative, experimental answer."

Often, in the course of shaping the regulations, complete redrafts  
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and a resubmission to the industry are necessary; sometimes, as

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196. It may be noted that this rule, known as the "arm's length bargaining rule," and one of the most controversial issued, was, unfortunately, not submitted to the industry prior to issuance. Its revision, however, is being so submitted and is currently the subject of well-publicized discussion and conference. It is in relation to this revision that the letter, set out in Appendix D, was circulated.

197. Landis, op. cit. supra, note 8, pp. 69-70.

198. The history of Regulation S-X, relating to accounting in financial statements filed under the '34 Act is illustrative of the time which may be consumed by the formulation of complex regulations. In 1936, the Chief Accountant's office wrote to selected experts, requesting their suggestions in respect of the accounting instructions for one of the registration forms. In January 1938, a preliminary draft of Regulation S-X was sent to over 400 persons and groups, including state securities commissions, exchanges, registrants and their attorneys, appraising and engineering firms, the American Bar Association, the Investment Bankers Association, the American Accounting Association, the American Institute of (cont'd)

occurred in respect of proxy rules, a proposed general revision of regulations may be abandoned altogether.

In general, the process of amendment and revision is much the same as that for the original issuance of regulations although as to minor changes, there is less likely to be submission to outsiders.<sup>199</sup> There is no established formal procedure for, and no policy of, reexamination at recurrent intervals; rather, the staff has the problem of the operations of the regulations constantly before it and has, accordingly, the question of revision continually in mind. Under the '33 and '34 Acts, considerable stability has been achieved in respect of regulations and forms, and revision is rather rare. On the other hand, the rules under the Holding Company Act are still in a process of development, and a more or less complete revision is now under consideration.

Publication of rules and regulations. Section 32

(a) of the Exchange Act provides that "no person shall be subject to imprisonment under this section for the violation

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198. (continued) Accountants, and like groups. Several hundred replies were received and analyzed by the staff in the course of the subsequent months. Conferences followed with several of the major groups and with smaller groups in Chicago, Boston, and New York. As a result, the draft was generally revised and again submitted to a smaller group of persons who had made contributions to its development. Conferences with the American Institute of Accountants were held thereafter; and the regulation was finally released in February 29, 1940.

199. Each of the Acts provides that none of its provisions imposing any liability "shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason."

of any rule, regulation or order of which he can prove he had no knowledge. Accordingly, wide distribution and publicity attends the promulgation of Commission rules and regulations. All "general rules and regulations"--that is, all rules and regulations except those governing matters of purely internal administration--, including the Commission's Rules of Practice, are published in the Federal Register. Forms and special instruction books for their use are not so published, but instead are filed with the Federal Register's Division for public inspection, while notice of such filing is published in the Federal Register.

In addition, the Commission makes every effort to bring to the affected public's attention notice of its rules and regulations. The policies underlying such publicity, and the methods of achieving it, have been described by the Commission's General Counsel:

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"...if there are to be rules, everyone ought to get a chance to know what they are. In the field of rule-making,...publicity is a vitally important factor, both for the protection of the public affected and for the purpose of keeping any governmental agency in line with democratic principles....On this theory the SEC has not been content merely to meet the requirements of the Federal Register Act. It has a large duplicating unit

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200. Lane, Address before the Legal Club of Chicago, March 20, 1939.



which produces thousands of copies of releases every week, and a service section which keeps up-to-date lists of individuals, companies, and law firms who want to be kept on the mailing list for various types of releases. Anyone wishing his name to be placed on the mailing lists need only tell us so, and he will receive the classification of releases he wants without charge. To illustrate: if the Commission adopts a new rule affecting trading in securities, it issues a release setting out the new rule...; it publishes the rule in the Federal Register; it sends out copies of the release--6,900 to registered brokers and dealers throughout the country, 2,400 to the people on 'list 4' (people who have requested announcements of rules and interpretations under the Exchange Act), 1,200 to a general list of people who request copies of all releases, and 600 to the public press."

In addition, periodic compilations are distributed without charge, and, whenever the supply of copies becomes low, a revised printed compilation containing all the rules and regulations under a particular Act is prepared. Although the great number of regulations and their terrifying series of numbers and letters may appear to make ready reference impossible to all except the initiate, in fact the Commission has developed a useful and simple system for finding the applicable rules. Under the '33 Act, rules have been grouped according to subject-matter under broad classifications designated "regulations" (e.g., "Regulation A, Exemptions, except those relating to oil and gas interests;" "Regulation C, Registration"), and subdivisions called "articles." The sequence in which articles and rules are arranged is based in general on the chronological order of steps involved in the registration of

securities. Rules relating to the same subject matter are assigned numbers in the same 100 series so far as practicable; to permit of additional rules gaps are left in the numbers after each group. A somewhat different system is utilized under the Exchange Act and the Holding Company Act; except for the "Rules of General Application," prescribing general procedure under each, the rule relates to a particular section under the Act. Thus Rule X-3A 12-1 is the first rule relating to Section 3(a) (12) of the Exchange Act; Rule U-9 A2-3 is the third rule relating to Section 9(a) (2) of the Holding Company Act. The regulations under each of these Acts are paged according to the section in groups of 100, so that, for example, rules under section 2 of the Holding Company Act begin on page 201 of the compilation of Holding Company Act regulations.

The Commission's general practice is to assign a future effective date to any rule which imposes a burden upon the persons  
201  
affected. The date assigned may be weeks, or even months, after publication and promulgation; the length of time is adjusted to the nature of the burden imposed. On the other hand, regulations granting exemptions or otherwise removing burdens become effective immediately upon publication. Occasionally, new forms may be adopted and used immediately; in that case, however, the Commission will provide

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201. Formerly, Rule 160 of the General Rules and Regulations under the '33 Act provided that, unless specifically provided otherwise, the rules and regulations thereunder "shall become effective on the sixtieth day after the publication date thereof." This has since been rescinded.

for the continued use of the superseded form for a specified period of time. Finally, it is to be noted that in a few exceptional cases, rules under the Holding Company Act imposing the duty of filing applications for approval before consummating certain transactions have been made effective immediately upon publication, because of the apparent danger, already described, that prior notice might stimulate some companies to take advantage of the grace period to complete their transactions and remove themselves from the field of regulation. (see supra, footnote 194).

Comments concerning the rule-making procedure: The absence of hearings. With the exceptions noted above, the Commission has made extraordinarily full and effective use of the consultative technique: There is no reason to believe that through it, and when it has been utilized, all views have not been canvassed and all experts who may have useful information or opinions have not been consulted. Nevertheless, some controversy has attended the absence of hearings, and criticism has been directed against the Commission  
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therefor, although it should be noted that, in the main, attorneys

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202. E.g., the letter addressed by Emmett F. Connely, president of the Investment Bankers Association of America, to Chairman Frank, criticising the absence of hearings on proposed Rule U-12) F-2, relating to the underwriting and sale of issues of securities of registered public utilities and their subsidiaries. The letter stated, "It is a matter of the highest importance in the public interest that questions which gravely affect the operation of our system of free enterprise should be aired in the full light of day. The evidence for and against every important question of policy concerning the regulation of business and the administration of laws relating thereto, should be heard and considered by impartial tribunals."

Mr. Connely protested against the "star chamber method" of deciding whether to promulgate the rule, and urged that a public hearing be held thereon before some group other than the Commission. New York Times, March 19, 1940, p. 44.

representing the persons affected by the regulations are content with the present procedure.

Certain classes and certain types of regulations seem clearly not susceptible to the hearing process. Such regulations include those relating to what has been described above as, in general, adjective implementing rules--those relating to forms and procedures. Rules of this nature are normally highly technical, dependent for their efficacy upon the working out of the most minute details.

Neither conflicting facts nor broad conflicting policies are likely to be involved; the subject-matter is one for intensive study, for the interchange of ideas among experts, and scarcely one for a lawyer's forum, witnesses, testimony and debates which a public hearing entail. The same is true of accounting regulations where gradual evolution by correspondence and discussion is necessary, and there is little question of two or more "sides" from which an arbiter can make a choice.

In respect of this type of regulations, it appears that hearings would be useless and sterile. They would be harmful only because of their consumption of time in an unnecessary gesture. On the other hand, to require hearings to precede some of the exemption rules might be affirmatively injurious. The speed and flexibility required by the dynamic subject-matter with which the Commission deals have already been noted; the need which arises often enough to make it a significant factor has also been described. At present, the Commission can, when the occasion arises and the individual finds immediate action imperative if his transaction is to be consummated, issue its regulation forthwith. Clearly the holding of a hearing would be of

little comfort to the individual when the opportunity for the transaction might long since have passed.

So, too, dispatch may militate against the desirability of hearings prior to rules which have here been termed "regulatory" and of a substantive nature. Occasionally action if it is to be useful at all must be quick: The Associated Gas episode described above, serves as a vivid illustration of a situation where irremediable damage would have been done by the time hearings could have been completed. But considerations of promptness are often not present in respect of this type of regulation; indeed, careful development and detailed study are as necessary to rules defining pegging, or regulating short-selling, or prescribing those conditions of arm's length bargaining under which underwriters and finders will be eligible for fees, as they are to accounting rules or the devising of forms. In respect of such rules, there is no wrong or right, no "truth," and again, little in the way of facts which may best be produced through the testimonial process. It is, of course, imperative that persons who may be affected, and experts, be consulted; to the agency's own expertness must be added the expertness--practical and otherwise--of outsiders. It can scarcely be expected that such regulations can be perfected in vacuo in the confines of the Commission. Studies of possible effects, the searching scrutiny of the persons to whom it would apply, and the views of the analysts in the field, are all necessary and useful. What, then, would a formal public hearing add? It can scarcely be doubted that if, for example, business man A wished to convince business man B that B should invest in A's plant, or

should join A's trade association, A would prefer an energetic and personal discussion across the table to the hiring of a lawyer who would produce witnesses to testify for a record before an umpire sitting on a bench. If, indeed, the conference method is available to those who are interested, it would seem that it is a method for persuasion of the Commission preferable, as far as the persuader is concerned, to the formal public hearing. Nor are analogies to star chambers complete or accurate: The very publicity which accompanies the debate preceding the issuance of these rules is indication that there is no suppression either of heat or light; and the wide circulation of the proposed rules calls the issues forcefully to the attention of those affected. Conversely, in terms of utility to the Commission, questionnaires, written criticisms, and calm and searching conferences would seem to be better suited to presenting to the Commission all the necessary information, data, and conflicting views than a hearing. Again, it may be repeated that the subject-matter with which the Commission deals is technical and dynamic--broad strokes cannot block in a suitable rule on arm's length bargaining or stabilizing and pegging; rather, in so far as tradition and precedent are applicable at all, it is on the side of the consultative technique, as witness the Federal Deposit Insurance Corporation and especially the Board of Governors of the Federal Reserve System. Both deal with the financial markets; the activities of the Federal Reserve in respect of margin rules and the like, are closely related to the subject-matter with which the Commission deals, yet consultation is the rule, and hearings virtually unknown.

But even if it is conceded that hearings are not ideally suited for the presentation of factual material and opinions and views of technicians, there might well still remain an area in which hearings are useful and salutary. Choice of conferees and persons consulted is necessarily limited under the present method; there must be a selection of persons outside the agency whose views will be sought. Although there is no reason to believe that in such selection the Commission has omitted important units or groups, the process of selection still is an individual one, resting within the discretion of the agency. On controversial questions raising fundamental issues, seriously affecting the customs and mores of segments of the business community, there is some question whether the agency should have the right of selection, no matter how wisely exercised (and of course, there is no guarantee that future Commissions will exercise it wisely). Especially, is this so when there is a tendency, unfortunate perhaps but nevertheless real, for only the organizations or individuals which have been described as "tamed" to respond to the invitations to confer; whether because of personal antagonism, pessimism, or preference for public battle on the record, not seldom the dissidents forego the privileges of the conference table and the discussions by correspondence. Further, conferences are available chiefly to organized groups: Within a particular segment of business men, there may be disagreement and the groups which confer may not be entirely representative. Majority rule need not be imposed upon the affected public if hearings are held. And still another interested group is not directly represented--except, of course, by the Commission

itself--in the conference method; the group composed of the investors consumers, and the public in general.

Public hearing following public notice would at least assure that all such groups will have an opportunity to speak their pieces; there is no danger that in the process of selection, any one would inadvertently<sup>be</sup>/missed since there will have been a general public invitation. In addition, the strong sentiment of some of the groups affected for speaking for the record in public is one not lightly to be dismissed; there is at least a possibility that such groups which are to be regulated will be more cheerful and compliant about being regulated if they have had an opportunity publicly to voice their objections before the regulator; at least that antagonism to a regulation which derives from displeasure at never having had a chance to make public objections on the record would be eliminated. Since, in fact, the Commission's staff must necessarily distill a great deal of the material submitted by outsiders through letters and through conferences with the staff, again public hearings in the nature of oral argument would afford an opportunity for the interested persons to present their views vis-a-vis to the commissioners who make the ultimate decision; there would thereby be assurance that these persons' views will have been delivered to the Commission unadulterated and undistilled. And, finally, such public hearings on the record may be some safeguard against arbitrary action since an agency may be more hesitant entirely to disregard objections which have been thus recorded.

The advantages of public hearing may, perhaps be largely psychological; such hearings may also serve more as the last step in the process, designed less for basic utility than as a final catch-all to



assure an agency that everything which can be said has been said. At the worst, some time would be lost without compensation in the way of useful discussion. But nevertheless, the advantages are such that in respect of the more controversial substantive regulations where speed is not of the essence, the Commission might do well to utilize the device of public hearings upon such regulations, as drafted on the basis of conferences and consultation, prior to their promulgation.

APPENDIX A

The Adjudicatory Functions  
of the Securities and Exchange Commission

I.

The Securities Act of 1933

- A. Registration Statement relating to the Issuance of Securities.
- (1) Issuance of an order refusing to permit statement concerning non-exempt securities to become effective.  
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- (a) Issuance of order suspending effectiveness of offering sheet relating to sale of fractional individual interests in oil or gas rights. Reg. B, Rule 340.
- (b) Issuance of an order suspending effective date of prospectus relating to interests in an oil royalty trust or similar type of trust or unincorporated association.  
Reg. B - T, Rule 380.

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203. As described above, p. 55, in the absence of adverse action registration statements (as amended) become effective 20 days after filing and the registrant is then entitled to sell securities. Non-action is, thus, in effect tantamount to issuance of a license which is subject to subsequent revocation; all registration statements, therefore, are the subject of some type of administrative consideration.

- (c) Determination, after issuance of refusal order, whether amendments comply with order so that registration will become effective. Section 8(b).
- (2) Issuance of an order suspending the effectiveness of a non-exempt security. Section 8(d) (stop orders).
  - (a) Determination, after issuance of stop order, whether amendments comply with such order so that stop order shall cease to be effective. Section 8(d).
- (3) Acceleration of effective date of pre-effective amendments by "consent" or "order". Section 8(a).
- (4) Determination of effective date of post-effective amendments to registration statements.  
Section 8(c).
  - (a) Determination of effective date of amendments to offering sheets. Reg. B, Rule 354.
  - (b) Determination of effective date of amendments to oil royalty and like trust procedures.  
Reg. B-T, Rule 392.
- (5) Granting or denying applications to withdraw registration statements. Rule 960.
  - (a) Granting or denying consent to withdrawal of offering sheets. Reg. B, Rule 350.

- (b) Granting or denying application for termination of effectiveness of offering sheet.  
Reg. B, Rule 356.
- (c) Granting or denying consent to withdrawal of oil royalty or similar type of trust prospectuses. Reg. B-T, Rule 390.
- (d) Granting or denying application for termination of such prospectuses. Reg. B-T, Rule 396.
- (6) Granting or denying applications for confidential treatment of material contracts. Schedule A, Par. 30.
- (7) Granting or denying application for dispensing with written consent under Section 7 of experts named as having prepared any part of the registration statement.  
Reg. C, Rule 671.

## II

### Securities Exchange Act of 1934.

#### A. Registration and Exemption of Exchange.

- (1) Registration or denial of registration of securities exchanges. Section 6 (e).
- (2) Setting of conditions under which exchange may withdraw its registration. Section 6(f).
- (3) Disciplinary suspension or withdrawal of registration for violation of Act or Rules and Regulations thereunder. Section 19(a)(1).

- (4) Exemption, upon application, of exchange because of limited volume of transactions. Section 5.
- B. Activities of and Membership in Registered Exchanges.
  - (1) Suspension or expulsion of any member or officer. Section 19(a)(3).
  - (2) Alteration or supplementation, by order and after request, of rules of registered exchange. Section 19(b).
- C. Exemption of Exchanges from Provisions, or Rules and Regulations Relating to Segregation and Limitation of Functions of Members, Brokers and Dealers. Section 11(c).
- D. Registration of Securities on National Securities Exchanges. Section 12.
  - (1) Acceleration of 30-day effective period. Section 12(d).
    - (a) Acceleration of 6-day effective period of registration of unissued securities for "when issued" trading. Rule X-12D3-6(c).
  - (2) Denial or Revocation of Registration. Section 19(a)(2).
    - (a) Denial of Registration of unissued securities for "when issued" trading. Rule X-12D3-8.
    - (b) Suspension or revocation of registration of unissued securities. Rule X-12D3-9.

- (3) Withdrawal or striking of security from listing and registration. Section 12(d).
- (4) Exemptions from registration requirements.
  - (a) Revocation of exemptions of certain warrants. Rule X-12A-4(d).
  - (b) Termination of exemption of certain securities resulting from modification of listed securities. Rule X-12A-5(c).
  - (c) Unlisted trading privileges.
    - (a) Continuation or extension of such privileges. Section 12 (f).
    - (b) Termination or suspension of such privileges. Section 12 (f).

E. Registration of Broker and Dealers on Over-the-Counter Markets. Section 15.

- (1) Acceleration of 30-day effective period. Section 15(b).
- (2) Deferring effective date upon the filing of amendments. Section 15 (b).
- (3) Denial or revocation of registration. Section 15(b).
  - (a) Postponement of effective date for 15 days. Section 15 (b).
  - (b) Postponement of effective date or suspension pending final determination. Section 15 (b).
  - (c) Withdrawal of registration. Section 15 (b).

F. Activities and Membership in Registered Securities

Associations.

- (1) Review of disciplinary action, including denial of admission taken by association. Sections 15 A (g) and (h).
- (2) Disapproval, abrogation, alteration or supplementation of association's rules. Sections 15 A (j) and (k).
- (3) Removal of officers or directors of association. Sections 15 A (1) and (3).
- (4) Suspension or expulsion of member associations. Sections 15 A (1) and (2).

H. Summary Suspension of Trading in Any Registered Security or of All Trading on any National Securities Exchange. Section 19(a)(4).

I. Granting or Denial of Objections to Disclosure of Information in Applications, Reports, or Documents. Section 24(b).

III

Holding Company Act of 1935.

A. Orders Declaring Status. Section 2.

- (1) Declaration that a company is not an "electric utility company." Section 2(a)(3).
  - (a) Revocation of such declaration. Section 2(a)(3).
- (2) Declaration that a company is not a "gas utility company". Section 2(a)(4).

- (a) Revocation of such declaration. Section 2(a)(4).
- (3) Determination that a person exercises such a controlling influence over the management and policies of a holding company or public utility that such person be subject to the Act as a holding company. Section 2(a)(7)(B).
- (a) Revocation of such determination. Section 2(b).
- (4) Declaration that a company is not a "holding company." Section 2(a)(7).
- (a) Revocation of such declaration. Section 2(a)(7).
- (5) Determination that a person is subject to a controlling influence by a holding company so as to be subject to the Act as a subsidiary. Section 2(a)(8)(B).
- (a) Revocation of such determination. Section 2(b).
- (6) Declaration that a company is not a subsidiary of a specified company. Section 2(a)(8).
- (a) Revocation of such declaration. Section 2(a)(8).
- (7) Determination that a person stands in such relation to a specified company that he be subject to the liabilities imposed upon affiliate. Section 2(a)(11)(D).



(a) Revocation of such determination. Section 2(b).

B. Exemptions of Holding Companies, Subsidiaries and Affiliates.

Section 3.

- (1) Of holding company or subsidiary if holding company's business is, inter alia, predominately intrastate, limited to one state and states contiguous thereto, or if holding company is incidentally or temporarily a holding company, or derives no material part of income from subsidiaries with foreign business. Section 3(a).
- (2) Of foreign subsidiary. Section 3(b).
- (3) Revocation of such exemptions. Section 3(c).
- (4) Permitting certain banks exempt as a holding company under Rule U - 3A3 - 1, upon application, to renew loans to certain utilities, holding companies or subsidiaries without losing exemption. Section U -3A3 - 1(b)(2).
- (5) Exemption of certain exempt banks from prohibition against voting utility securities, which conduct would otherwise cause the loss of the exemption. Section U -3A3 - 1(b).

C. Registration. Section 5.

- (1) Requiring further information regarding holding company or associate companies Section 5(b)(3).
- (2) Termination of registration upon finding that registered holding company has ceased to be a holding company. Section 5(d).

D. Security Transactions by Registered Holding and Subsidiary Companies.

(1) Issue and sale of own securities.

- (a) Exemption from standards of Section 7 of issue and sale of securities by subsidiary under stated circumstances. Section 6(b).
- (b) Authorizing or refusing to authorize the issue, renewal, or guaranty of a note or draft aggregating more than 5% of the principal amount and par value of the other securities of the company without losing exemption of the transaction from the requirements of section 6(a). Section 6(b).
- (c) Approval or disapproval of declaration concerning issue or sale of declarant's securities or alteration of priorities, preferences or rights of its security holders. Section 7(b).

(2) Acquisition of securities, utility assets and other interests.

- (a) Approval or disapproval of investment program for current funds, relieving company of requirements of further application for acquisition of securities, etc. Rule U-9C-4(a).
- (b) Approval or disapproval of application to acquire securities. Section 10(d).
  - (i) Revocation of approval order. Rule U-9C-4(g)
  - (a) Summary suspension of order pending final determination. Rule U-9C-4(g).

- (3) Intercompany transactions, loans, dividends, security transactions, sale of utility assets and proxies.

Section 12.

- (a) Approval or disapproval of applications to extend credit or indemnify foreign associates where the proposed transaction exceeds a certain amount. Rule U - 12B - 1(b)(c).
- (b) Approval or disapproval of transactions involving extension of credit or indemnification of any company in same holding system. Section 12(b).
- (c) Approval or disapproval of declaration or payment of dividends out of unearned capital or surplus. Section 12(c).
- (d) Approval or disapproval of sale by any registered holding company of any security which it owns of any public utility company, securities or any utility assets. Section 12(d).
- (e) Approval or disapproval of declarations concerning solicitation of proxies, consents, dissents, deposits and the like in connection with a plan of reorganization. Section 12(e); Rule U - 12E - 3(a)(3); Rule U - 12E - 5.
  - (i) Acceleration of 15-day effective period for amendments. Rule U - 12E - 5(c).
  - (ii) Authorization of person to solicit more than 25 owners of securities without being required to file declaration. Rule U - 12E - (b)(1).

- (f) Granting or dismissing applications for reports on plans of reorganization in respect of registered holding companies and subsidiaries. Section 11(g); Rule U - 12E - 4.
- (g) Approval or disapproval of sales of securities or utilities assets to associates or affiliates. Section 12(f); Rule U - 12F - 1.
- (h) Finding, in connection with all acquisition or sale of securities, that a person stands in such relationship to the applicant or declarant that there is likely to be an absence of arm's length bargaining so as to render such person ineligible to receive an underwriter's or finder's fee. Rule U - 12F - 2(1)(3).

E. Simplification of Holding-Company Systems.

- (1) Issuance of order requiring integration.
  - (a) Permitting a registered holding company to control one or more additional integrated holding systems. Section 11(b)(1).
- (2) Issuance of order requiring simplification. Section 11(b).
- (3) Revocation or modification of simplification or integration order. Section 11(b).
- (4) Approval or disapproval of a voluntary plan of simplification and integration. Section 11(e).

F. Reorganization.

(1) Approval or disapproval of any reorganization plan prior to submission to court. Section 11(f), Rule U -11F - 1.

(2) Approval or disapproval of fees, expenses and remuneration, in connection with any reorganization, liquidation, bankruptcy or receivership. Section 11(f); Rule U - 11F - 2.

G. Service, Sales and Construction Contracts. Section 13.

(1) Approval or disapproval, upon application, of a company as a mutual service company. Rule U - 13-22(c).

(2) Approval or disapproval of a declaration filed by subsidiary of a registered holding company wishing to act as a service company. Rule U - 13-22(d).

(3) Revocation of approvals under (1) and (2). Rule U -13-22(e).

(4) Exemption of a subsidiary which acts as a service company for a foreign associate. Rule U-13-4.

(5) Issuance of an order requiring a reapportionment or reallocation of costs among member companies of a mutual service company. Section 13(d).

H. Granting or Denial of Objections to Disclosure of Information in Applications, Declarations, Reports of Documents. Section 22(b).

I. Accounting Practices.

(1) Ordering changes in methods of accounting and prescribing modification or supplementation of particular entries. Section 15, especially Section 15(f).

## APPENDIX B

### Express Powers Vested in the Securities and Exchange Commission to Issue Rules and Regulations

#### I.

##### The Securities Act of 1933

###### A. General.

- (1) "To make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of this title," including rules governing registration statements and prospectuses, rules prescribing forms, and rules defining accounting, technical and trade terms used in this title. Section 19(a).

###### B. Exemptions.

- (1) To add to the statutory exemptions of securities where the issue does not aggregate in amount more than \$100,000 as offered to the public. Section 3(b).

###### C. Registration statements and prospectuses.

- (1) To dispense with certain information in a registration statement otherwise required by the Act. Section 7.
  - (a) Same for a prospectus. Section 10(b)(2).
- (2) To add to the statutory requirements in regard to information to be included in registration statements. Section 7.
  - (a) Same for a prospectus. Section 10(b)(3).
- (3) To classify prospectuses and prescribe the information to be supplied by such classes. Section 10(b)(4).

- (4) To prescribe the methods of filing a prospectus which consists of a radio broadcast. Section 10(d).
- (5) To prescribe forms and details:
  - (a) For stating in the balance sheet all the assets and liabilities of the issuer. Schedule A, clause 25.
  - (b) For statement of profit and loss, depreciation, depletion and maintenance charges. Schedule A, clause 26.
  - (c) For statement of receipts and expenditures in case of securities of a foreign government. Schedule B, clause 5.
- (6) To prescribe special forms of registration statements calling for appropriate information in respect of certificates of deposit, voting trust certificates, collateral trust certificates and like securities. Schedule A, last paragraph.

## II.

### Securities Exchange Act of 1934

#### A. General.

- (1) "To make such rules and regulations as may be necessary for the execution of the functions vested in [it] by this title, and . . . classify issuers, securities, exchanges, and other persons or matters . . ." Section 23(a).

#### B. Definitions.

- (1) To provide supplemental definitions of "equity securities". Section 3(a)(11).

- (2) To define technical, trade and accounting terms used in the Act. Section 3(b).

C. Exemptions.

- (1) Total or partial exemption of particular kinds of securities from operation of Act. Section 3(a)(12).
- (2) Exemption of transactions from the statutory restrictions upon profits arising out of transactions in securities by directors, officers or 10% stockholders. Section 16(b).

D. Prescription of forms and information to be supplied.

- (1) Form for application of securities exchange registration. Section 6(a).
- (2) Information to be supplied by applicant exchange. Section 6(a)(1).
- (3) Information to be supplied by issuer seeking registration of security for trading on national securities exchange. Section 12(b)(1).
- (4) Form of and information to be supplied in annual reports of issuers of securities registered on a national securities exchange. Section 13(a); 13(b).
  - (a) Same for securities registered under the 1933 Act. Section 15(d).
- (5) Information to be supplied by broker or dealer seeking registration for transacting an over-the-counter business. Section 15(b).
- (6) Forms and information to be supplied by officers, directors and 10% stockholders in respect of their ownership of equity securities in their companies. Section 16(a).



(7) Rules governing the keeping of accounts, correspondence, memoranda, papers, books and other documents by securities exchanges, members thereof, brokers and dealers transacting business through such members, registered securities associations, and registered brokers or dealers. Section 17(a).

(8) Form of and information to be supplied by association of brokers or dealers seeking registration as national securities association. Section 15A(a).

E. Activities of members of exchanges, brokers and dealers.

(1) Limitation upon the aggregate indebtedness of an exchange member or a broker or dealer who transacts a securities business through such member. Section 8(b).

(2) Regulation of hypothecation by securities exchange member or broker or dealer dealing through such member. Section 8(c).

(3) Regulations governing floor trading by brokers for own account, excessive trading off the floor. Section 11(a).

(4) Regulations governing activities of odd-lot dealers and specialists. Section 11(b).

(a) Exemption of exchanges from such rules. Section 11(c).

F. Manipulation.

(1) Rules governing pegging, fixing or stabilizing security prices. Section 9(a)(6).

(2) Rules governing use of facilities of a national securities exchange for effectuating transactions involving puts, calls or straddles. Sections 9(b) and 9(c).

- (3) Rules governing short sales and stop-loss orders.  
Section 10(a).
- (4) Rules governing utilization of "manipulative and deceptive" devices in general. Sections 10(b); 15(c)(1).
- (5) Definition of devices which are "manipulative, deceptive, or otherwise fraudulent" for purposes of dealing otherwise than on a national securities exchange. Sections 15(c)(1); 15(c)(2); 15(c)(3).

Miscellaneous.

- (1) Rules governing exchange's withdrawal of registration.  
Section 6(f).
- (2) Rules governing registration of unissued securities.  
Section 12(d).
- (3) Suspension of unlisted trading privileges in whole or in part for any or all classes of securities for not more than 12 months. Section 12(f).
- (4) Rules governing the solicitation of proxies in respect of any security registered on a national securities exchange.  
Section 14.
- (5) Residual power to supervise rules and regulations of registered securities associations. Sections 15A(b); 15A(c); 15A(j); 15A(k).
- (6) Rules governing application of statutory provisions limiting security transactions by directors, officers, and principal stockholders, to foreign or domestic arbitrage accounts. Section 16(d).

- (7) Residual power over rules and regulations of national securities exchanges. Section 19(b).
- (8) Rules governing trading on foreign securities exchanges. Section 30(a).

### III.

#### Public Utility Holding Company Act of 1935<sup>204</sup>

##### A. General.

- (1) "To make, issue, amend, and rescind such rules and regulations . . . as it may deem necessary or appropriate to carry out the provisions of this title," including rules and regulations defining technical, trade and accounting terms, and prescribing forms of applications, balance sheets, and information. Section 20(a).
- (2) To classify persons and matters within its jurisdiction. Section 20(c).

##### B. Definitions.

- (1) Provision that any specified class or classes of companies shall not be deemed electric utility companies. Section 2(a)(3).
- (2) Provision that any specified class or classes of companies shall not be deemed gas utility companies. Section 2(a)(4).

##### C. Exemptions.

- (1) To exempt both holding companies and subsidiaries.

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204. It is to be noted that in most instances under this Act, it is provided that the Commission may proceed by rules and regulations or orders. E.g., Section 3(a).

- (a) Where the holding company and its subsidiaries are predominantly intrastate and carry on this business substantially in a single state where the companies are organized. Section 3(a)(1).
  - (b) Where the holding company is predominantly a public-utility company whose operations do not extend beyond the state in which it was organized and states contiguous thereto. Section 3(a)(2).
  - (c) Where the holding company is only incidentally a holding company and does not derive any material part of its income from public utility subsidiaries. Section 3(a)(3).
  - (d) Where the holding company is temporarily a holding company. Section 3(a)(4).
  - (e) Where the holding company is not and derives no material part of its income from domestic public-utility subsidiaries. Section 3(a)(5).
- (2) To exempt subsidiaries.
- (a) When the subsidiary does not operate in the United States and derives no material part of its income therefrom. Section 3(b).
- (3) To exempt conditionally or unconditionally any specified class or classes of persons from the obligations, duties or liabilities imposed upon such persons as subsidiaries or affiliates. Section 3(d).

- (4) To exempt from the prohibition against security transactions not in accordance with an effective declaration the issue and sale of securities by a subsidiary if such issue and sale is solely for the purpose of financing the business of such subsidiary and (a) it has been approved by the proper state commission; or (b) the subsidiary is not a holding company, a public-utility or like company. Section 6(b); Section 9(c)(2) and (3).
- (5) To exempt transactions by a holding company from the requirements and prohibitions of Section 13 (relating to service, sale, and construction contracts.) Section 13(a).  
(a) Parallel exemption in regard to subsidiaries.  
Section 13(b).
- (6) Exemption of transactions from the statutory restrictions upon profits arising out of transactions in securities by directors, officers, or other affiliates. Section 17(b).
- (7) Exemption from prohibitions against interlocking relationships between banks and utilities. Section 17(c).

D. Prescription of forms and information to be supplied.

- (1) Forms and information for holding companies seeking registrations. Section 5(a); 5(b).  
(a) Fixing of time for filing of such information.  
Section 5(b).
- (2) Information to be supplied by subsidiary whose issue and sale of securities is exempted under Section 6(b).

- (3) Forms and information to be supplied in declarations by registered holding and subsidiary companies in respect of the issue and sale of any securities of such company or the exercise of any privilege to alter the priorities or rights of outstanding security holders. Section 7(a).
- (4) Forms and information to be supplied in applications for the acquisition of securities, utility assets and other interests. Section 10(a).
- (5) Forms and information to be supplied by representatives of registered holding companies and subsidiaries. Section 12(i).
- (6) Prescribing the making of reports in general. Section 14.
- (7) Prescribing the keeping of accounts, papers, records, correspondence and the like. Sections 15(a); 15(b); 15(c); 15(d).
- (a) Prescribing the form and manner of keeping accounts including uniform cost accounting. Section 15(i).
- (8) Forms and information to be supplied by officers, directors and other affiliates in respect of their ownership of securities in their companies. Section 17(a).
- (9) Rules permitting incorporation by reference of information already filed with Commission. Section 20(d).

E. Intercompany transactions.

- (1) Rules governing acquisitions by affiliates.

- (2) Rules governing intercompany loans, extensions of credit, or indemnifications. Section 12(b).
- (3) Rules governing the payment of dividends, or the acquisition, retirement, or redemption of own securities. Section 12(c).
- (4) Rules governing the competitive conditions, fees, commissions and the like involved in the sale of public utility securities or assets by a holding company or subsidiary. Section 12(d).
- (5) Rules governing the solicitation of proxies. Section 12(e).
- (6) Rules governing reports, accounts, maintenance of competitive conditions, disclosure of interest and the like in the course of any transaction with an associate company or an affiliate. Sections 12(f) and 12(g).

F. Service, sales, and construction contracts.

- (1) Regulations governing the performance by subsidiaries of any service, sales or construction contracts for any associate company. Section 13(b).
- (2) Regulations prescribing terms and conditions regarding the determination and allocation of costs of service, sales, and construction contracts, the keeping of accounts and reports therefor, and the like. Section 13(c).
- (3) Regulations prescribing terms and conditions regarding the manner in which applications may be made for approval as a mutual service company, the nature and type of businesses in which such companies may engage, and the methods thereof. Section 13(d).

- (4) Regulations regarding accounts, reports, costs, maintenance of competitive conditions and the like for performance by affiliates or others of service, sales, and construction contracts. Section 13(e); 13(f).

G. Miscellaneous.

- (1) Fixing of time upon which a declaration under Section 7(a) shall become effective. Section 7(b).
  - (a) Same for applications for acquisition of securities. Section 10(d).
- (2) Regulations authorizing issue and sale of securities the issuance of which was authorized by the company prior to January 1, 1935. Section 7(c)(3).
- (3) Prescription of the amounts of readily marketable securities in which a registered holding company or subsidiary can invest current funds without being required to apply for approval of acquisition of securities under Sections 10; 9(a)(2).
- (4) Limitations upon the commercial paper and other securities which may be acquired in the ordinary course of business without an application for approval of acquisition of securities under Sections 10; 9(c)(3).
- (5) Rules governing proposal of reorganization plans by any person having a bona fide interest therein. Sections 11(d); 11(f).
- (6) Rules governing the submission of voluntary integration and simplification plans. Section 11(e).



- (7) Rules governing approval of fees, expenses and remunerations in connection with reorganizations, dissolutions and the like. Section 11(f).
- (8) Rules governing the solicitation of proxies in connection with reorganization plans. Section 11(g)(3).

APPENDIX C

Statistics Concerning the Work Load of the  
Commission

I

Matters Coming Before the Commission

A. Securities Act.

July 1, 1938 to June 30, 1939

1. Registration statements

- |                                |                             |
|--------------------------------|-----------------------------|
| a. Filed: 375                  | g. Prospectuses filed: 328  |
| b. Became effective: 359       | h. Sets of supplemental     |
| c. Withdrawn with consent: 69  | prospectus material: 244    |
| d. Stop orders: 6              | i. Sets of 13 month prosec- |
| e. Under examination at end of | tuses [Section 10(b)(1)]:   |
| year: 60                       | 413                         |
| f. Amendments filed: 1,275     |                             |
| (exclusive of 463 delaying     |                             |
| amendments).                   |                             |

Total for year: effective registrations of \$2,494,000,000 of securities.

2. Exemption from registration (Regs. A, B, and B-T) July 1, 1938 to June 30, 1939

- a. Prospectuses for issues aggregating less than \$100,000 (Reg. A. Rule 202): 179 (\$13,352,323 representing mainly stocks).
- b. Oil and gas offering sheets (Reg. B): 1,607 (c. \$25,000,000)

- (1) amendments filed: 633
- (2) temporary suspension orders: 396
- (3) permanent suspension orders: 1
- (4) orders terminating proceeding after amendment: 246
- (5) orders consenting to withdrawal: 153
- (6) orders terminating effectiveness of sheet: 87
- (7) orders consenting to amendment: 282
- (8) orders for hearing: 1
- c. Oil royalty trust prospectuses (Reg. B-T): 2 (\$119,200)
  - (1) temporary suspension orders: 2
  - (2) permanent suspension orders: 1
  - (3) orders consenting to withdrawal: 1

B. Securities Exchange Act:

July 1, 1938 to June 30, 1939

- 1. Registration and Exemption of exchanges: .0 (present number of exchanges: 20 registered; 7 exempted)

- a. amendments filed: 225

- 2. Registration of securities on exchanges

- a. Applications on basic forms: 281

- b. Applications for "when issued" trading: 19

- c. Exemption for issued warrants: 24

- d. Annual and current reports: 4,657

- e. Amendments to applications and reports: 3,210

- f. Annual reports of issues having securities listed on exempted exchanges: 125

- (i) Delisting by Commission under Section 19 (a) (2)

- Action instituted: 16

- Dismissed: 2

Orders withdrawing from registration: 5

Pending at end of year: 12

- (ii) Striking from listing on applications of others under  
Section 12 (d)

Applications: 54

Granted: 60

Pending at end of year: 15

- (iii) Extension or termination of unlisted trading privileges

Under 12 (f) (2)

Applications: 116

Decision reserved: 2

Granted: 63

Withdrawn: 5

Denied: 25

Pending at end of year: 46

Under 12 (f) (3)

Applications: 3

Granted: 7

3. Registration of securities association

a. Filed (7/20/39): 1

b. Granted (8/7/39): 1

4. Registration of brokers and dealers

Total effective at close of fiscal year 6,796.

a. Filed: 1,135

e. Registrations denied: 4

b. Applications withdrawn: 25

f. Suspended: 6

c. Registrations withdrawn: 965

g. Revoked: 19

d. Registrations cancelled: 131

h. Pending at end of year: 75

5. Proxies [Section 14 (a)].

a. Filings: 1,595

b. Supplemental filings: 557

C. Holding Company Act

July 1, 1938 to June 30, 1939

1. Issue and sale of securities

- a. Applications and declarations filed: 166
- b. Approved: 122 (\$1,449,810,000 of securities issued)
- c. Denied: 0
- d. Withdrawn or dismissed: 13
- e. Pending: 60

2. Acquisition of securities

- a. Applications: 71
- c. Denied: 8
- b. Approved: 45
- d. Withdrawn or dismissed: 23

3. Integration and simplification proceedings

- a. Integration proceedings begun: 1
- b. Voluntary Section 11 (e) plans
  - (i) Received: 8
  - (iii) Denied: 0
  - (ii) Approved: 2
  - (iv) Pending at end of year: 7

4. Reorganization

- a. Plans
  - (i) received: 17
  - (iv) Withdrawn or dismissed: 4
  - (ii) Approved: 10
  - (v) Pending at end of year: 22
  - (iii) Disapproved: 0
- b. Fees and expenses
  - (i) Applications received: 57
  - (ii) Approved: 15
  - (iii) Denied: 1
  - (iv) Pending: 41

6. Service companies
    - a. Applications received: 6
    - b. Approved: 11
    - c. Denied: 0
    - d. Pending: 10
  7. Exemptions
    - a. Applications received: 23
    - b. Approved: 15
    - c. Denied: 8
    - d. Withdrawn or dismissed: 51
    - e. Pending: 79
  8. Acquisition or redemption of own securities [Section 12 (c)]
    - a. Applications received: 17
    - b. Approved: 10
    - c. Denied: 0
    - d. Withdrawn or dismissed: 1
    - e. Pending: 9
  9. Dividend declarations and payments
    - a. Applications received: 5
    - b. Approved: 7
    - c. Denied: 0
    - d. Pending: 1
  10. Sale of public utility securities and utility assets
    - a. Applications received: 78
    - b. Approved: 42
    - c. Denied: 0
    - d. Dismissed or withdrawn: 3
    - e. Pending at end of year: 39
- D. Confidential treatment cases.

	SA '33	SEA '34	HCA
Applications	21	101	16
Hearings		16	
Denied or withdrawn	1	57	
Granted	19	41	1
Pending	3		15

## Public Hearings Held

7/1/35 - 6/30/37 7/1/37-6/30/38 7/1/38-6/30/39

SA '33	229	62	29
SEA '34	81	116	198
HCA	304	191	295
<hr/>			
Total	614	369	522

## III

Formal Opinions: July 1, 1938 to June 30, 1939

## A. Securities Act

Total 15

## 1. Fixing effective date of amendments

to registration statement 1

## 2. Permanent suspension order 1

## 3. Stop orders 13

## B. Securities Exchange Act

46

## 1. Broker-dealer registration 17

## 2. Manipulation 1

## 3. Unlisted trading 14

## 4. Withdrawal from registration 14

## C. Holding Company Act

300

1. Acquisition of securities, assets,  
and the like 35

## 2. Acquisition of own securities 13

## 3. Fees, expenses and remunerations 11

4. Declaring company not to be an  
electric utility 1

5. Declaring company not to be a holding company	12
6. Declaring company not to be a subsidiary	8
7. Declaring company to be a subsidiary	3
8. Dividend declarations and payments	8
9. Exemptions of companies	15
10. Exemptions of issuance and sale of securities	47
11. Exemptions of acquisition of securities	1
12. Issue and sale of securities	66
13. Investment program for current funds	1
14. Mutual service companies	6
15. Reorganization and recapitalization plans	16
16. Sale of utility securities and assets	32
17. Sale of utility securities and assets to associates or affiliates	10
18. Solicitation and authorization in connection with reorganizations	9
19. Subsidiary service companies	6
D. Total formal opinions:	266
Total issues:	342



## IV

## Sample Breakdown of Work-Load

The following are the statistics compiled by an observer in respect of 15 test-cases, decided July 1, 1936, to June 30, 1937:

Decision (P)	Hearing P - Pages (P)	Examiner's Report (P)	Briefs N - Number (P)	Exhibits (N)	Amendments (N)
9	303	13		8	8
39	705	44	302	31	1
2	5	3			3
4	17			3	1
13	162	27	140	12	
2	7			5	2
4	19	7			
6	78	10	21	8	
3	48	12		16	2
11	163	8	36	10	8
2	40	9		7	6
6	13			17	
8	150			50	3
39	4,759	22	53		
2	16	2		18	2
150	6,475	157 (in 11)	542 (in 5)	185 (in 12)	50 (in 10)

"Thus, the average case has, in this statistic, ten pages of decision, 430 pages of hearing-transcript, ten pages of examiner's reports, 35 pages of brief, three amendments and 12.5 exhibits, and it lasts two weeks.

"Considering that there were 183 cases in this period, there were a total of 178,690 pages of hearing-transcript, 1,830 pages of examiner's report, 6,405 pages of brief, 549 amendments and 2,287.5 exhibits."

The same observer makes the following estimate of the daily work-load of the commissioners: 6 exhibits, 1.5 amendments, 15 pages of brief, 3 pages of trial examiner's reports, 210 pages of transcripts of hearing, .5 oral arguments, 1.5 complaints of alleged violations, 1.8 prospectuses of issues, 3.6 oil offering sheets, 0.6 stop- , consent - , refusal or withdrawal orders, and 24 pages of decision. In addition, there must be joint or individual discussion with other members of the staff or outsiders, speeches, hiring of non-civil service employees, and similar executive and administrative duties.

APPENDIX D

Letter accompanying requests for discussion prior  
to the issuance of rules and regulations

Dear Sir:

By express provisions of the Public Utility Holding Company Act of 1935 the Securities and Exchange Commission is charged with the "maintenance of competitive conditions" and directed to construe that Act so as to assure the "elimination of the evils which result from an absence of arm's-length bargaining or from restraint of free and independent competition" in the distribution of securities of registered public utility holding companies and their public utility company subsidiaries.

This requirement to maintain competitive conditions and arm's-length dealing is, as you know, strictly limited to companies subject to the provisions of the Public Utility Holding Company Act of 1935. On December 28, 1938 the Commission, in accordance with the provisions of that Act, adopted a rule under the Act relating to the fees and commissions of investment bankers and others who may be "affiliates" of public utility companies seeking to issue securities under the provisions of the Act. Without expressing any conclusion as to the feasibility of alternatives to this rule, we are nevertheless willing to consider technique which may be less burdensome from the standpoint of the issuer and more effective from the standpoint of the Commission in meeting the requirement of the Public Utility Holding Company Act of 1935 to preserve competition and arm's-length bargaining in the distribution of utility securities.

As it has done in other instances, the Commission is seeking the views of interested and informed members of the public. Accordingly, you are invited to submit not later than March 18, 1940 a written memorandum on the following question:

In the light of the express direction in the Public Utility Holding Company Act of 1935 to construe the several provisions of the Act to eliminate "transactions in which evils result from an absence of arm's-length bargaining or from restraint of free and independent competition", by what method or methods can the Commission best insure the reasonableness of fees and commissions, and the fairness of the terms and conditions of any proposed issue and sale of utility securities?

One method, in addition to the present "affiliate" rule, which has been suggested for preserving competition in the underwriting and sale of utility securities has been a requirement of proof that the issuer has "shopped around" among investment bankers for the most favorable terms. Another method suggested has been the use of sealed bids. There may well be others. The Commission is not committed to any method of procedure.

With respect to the particular method which you may recommend, the Commission would appreciate your views as to the following:

- (a) What would be the specific effect, as you see it, of the plan you propose upon (1) the issuer of the public utility securities, (2) the underwriters and distributors of the public utility securities and (3) investors in public utility securities?
- (b) In applying your proposal, should it be applicable to all grades of securities or should a distinction in application of the proposal be made with respect to certain grades of securities?
- (c) Should there be a differentiation between cases where the underwriters are affiliates, within the meaning of the statute, and where they are not?

In replying to the foregoing questions, as well as in your general discussion of the problems, it will be helpful if you will make reference to concrete cases and occurrences within your own experience and knowledge.

The Commission requests that you limit your discussion to the problem as it arises under the Public Utility Holding Company Act of 1935. The maintenance of competitive conditions and arm's-length bargaining in the underwriting and sale of securities other than those subject to the Public Utility Holding Company Act is beyond the jurisdiction of this Commission and hence is not at issue here. By the same token, since it is the Commission's duty to enforce the law as it is written, it is felt that discussion of the merits of this particular aspect of the law would, in this connection, be of little assistance. What is sought is technical advice to the end that any new rule may be less burdensome and more adequate in meeting the requirements of the statute.

We are especially desirous of obtaining the views of the utility commissioners of the several States and of other regulatory authorities; of executives of utility companies subject to the provisions of the Public Utility Holding Company Act of 1935; of investment bankers and dealers in utility securities issued pursuant to the provisions of the Public Utility Holding Company Act of 1935; of the National Association of Securities Dealers, Inc. and the Investment Bankers Association; and of other interested persons who are expert in the field, or who may be affected by any revision of our rule.



For your convenience, a copy of the existing rule above referred to is annexed.

Very truly yours,

Securities and Exchange Commission

By: Joseph L. Weiner,  
Director, Public Utilities Division